

After the crisis: what kind of home ownership policies?

Global financial crisis, uneven repercussions for homeowners

The financial crisis has provoked a property crisis all over the world. Everywhere the number of house sales and of new constructions has dropped dramatically. However, the repercussions for borrowers have varied widely from country to country. In some countries the rate of defaulting borrowers in 2008 has skyrocketed in comparison to 2007. That is the case with the United States, Great Britain and Spain, whereas, for the time being, Germany, the Netherlands, Italy, France and even Canada appear to be avoiding a rise in the number of defaults and repossessions. In these countries the current mortgagors are not, yet, in trouble. The difficulties will probably come later, but this will be caused by the economic crisis and concurrent rise in unemployment.

How can these differences be explained? What are the risk factors for home-owners? Once the crisis is over, governments will have to decide about their housing policy. Homeownership will very probably remain in favour in most countries, for the same reasons as previously, (it is the preference of households, it results in a lower burden on public spending, increased involvement in the community and permits the accumulation of assets in anticipation of retirement). What can be learned in relation to the soundness of public policies fostering home ownership and regarding the ways and means used by the public authorities for the implementation of these policies? The present economic crisis provides a timely opportunity to address these questions. These reflections cannot be oriented towards immediate application, since in the short term ensuring employment will be the primary concern.



I. From excess of liquidity to a global housing crisis

Excess of liquidity, falling interest rates, rising prices

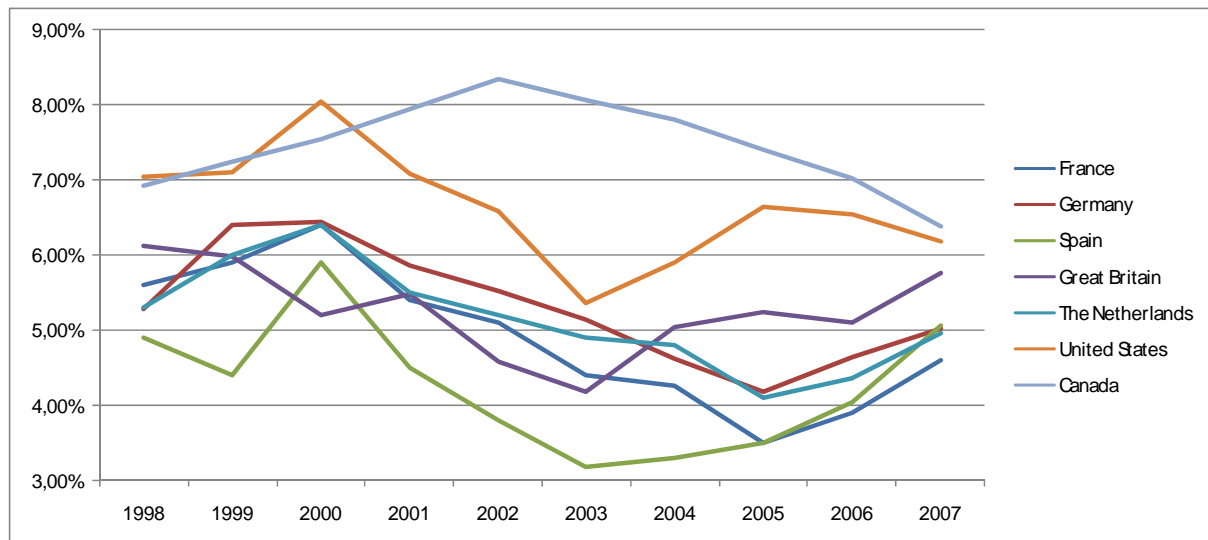
The origin of this crisis is, of course, to be found in the deep imbalances which go beyond housing finance and the financial turmoil would have been the same had the loans financed anything other than housing. The excess of liquidity, caused primarily by the constant increases to the US deficit, Asian commercial surpluses and oil producing countries' surpluses, resulted in interest rates falling, the prices of all assets – first of all housing - going up, and the level of indebtedness rising. Alongside these imbalances, innovations in financial technology have allowed a considerable increase in the level of indebtedness.

For France, the history of the regulated loan for housing rates (*prêt conventionné*) reveals a measure of this decline. The two extremes are located in May 1982, when the ceiling rate for a loan of 15 years was 17.95%, and in September 2005, when the rate was lowered to 5.85%. It was 10.50% in March 1995.

Evolution of mortgages interest rates

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
France	5.60%	5.90%	6.40%	5.40%	5.10%	4.40%	4.25%	3.50%	3.90%	4.60%
Germany	5.29%	6.40%	6.44%	5.87%	5.52%	5.14%	4.63%	4.19%	4.64%	5.03%
Spain	4.90%	4.40%	5.90%	4.50%	3.80%	3.18%	3.30%	3.50%	4.03%	5.06%
Great Britain	6.12%	5.98%	5.19%	5.48%	4.58%	4.18%	5.04%	5.23%	5.10%	5.75%
The Netherlands	5.30%	6.00%	6.40%	5.50%	5.20%	4.90%	4.80%	4.11%	4.37%	4.96%
United States	7.05%	7.11%	8.05%	7.09%	6.59%	5.37%	5.91%	6.66%	6.55%	6.19%
Canada	6.93%		7.56%		8.35%		7.84%		7.02%	6.39%

Source FHE



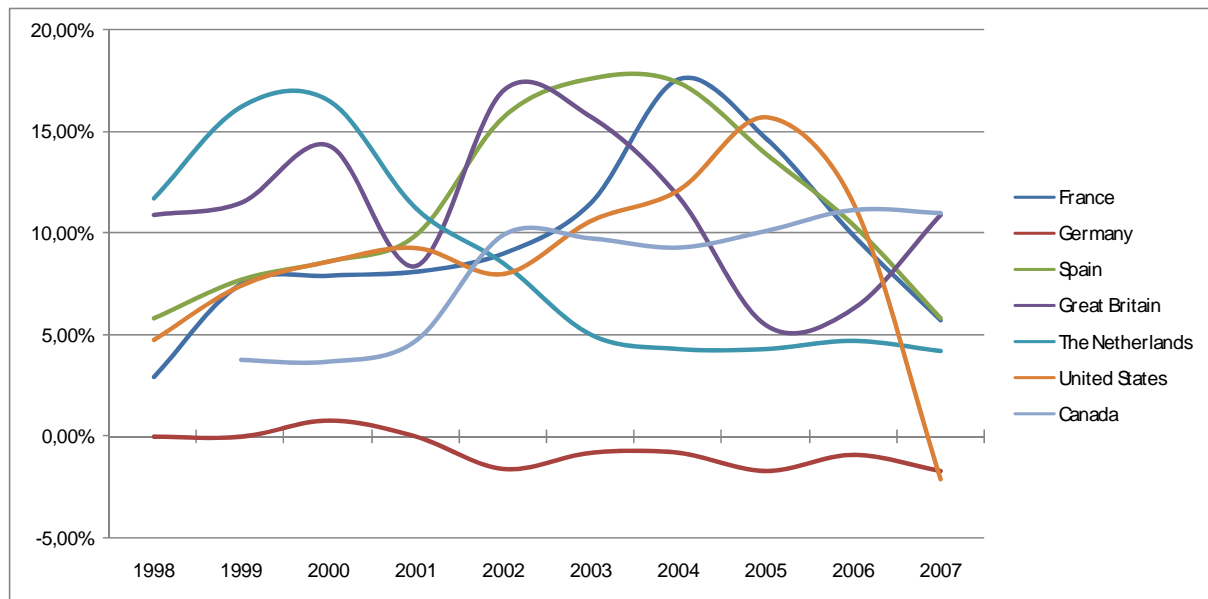
The globalization of the financial system has resulted in interest rates being reduced in all the open economies. It has provoked an increase of prices, albeit an uneven but almost universal one. In France, housing prices increased by a factor of 2.5 between 1996 and 2007; a higher rate than in the United States during the same period.

Among the seven countries in the following table the only exception to the general increase is Germany.

Housing price variations

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
France	2.9%	7.5%	7.9%	8.1%	9.0%	11.5%	17.6%	14.7%	9.9%	5.7%
Germany	0.0%	0.0%	0.8%	0.0%	-1.6%	- 0.8%	- 0.8%	- 1.7%	- 0.9%	-1.7%
Spain	5.8%	7.7%	8.6%	9.9%	15.7%	17.6%	17.4%	13.9%	10.4%	5.8%
Great Britain	10.9%	11.5%	14.3%	8.4%	17.0%	15.7%	11.8%	5.5%	6.3%	10.9%
The Netherlands	11.7%	16.2%	16.5%	11.2%	8.5%	5.0%	4.3%	4.3%	4.7%	4.2%
United States	4.75%	7.43%	8.60%	9.27%	7.99%	10.6%	12.1%	15.7%	11.5%	- 2.1%
Canada		3.79%	3.70%	4.73%	9.90%	9.73%	9.28%	10.09%	11.12%	10.97%

Source FHE



A heavier burden for first time home-owners

Thus, the fact that interest rates have fallen and remain, since 2003, at a very low level has led to a profound change in the mortgage process. One must pay the same each year but over a longer period. The end result for households is a heavier debt burden, as repayment is extended over a longer period of time. Thus, in France, in 1996 it took 3.5 years of income for a household in the 70th percentile to repay its mortgage while in 2006 it took 5 years. First-time homeowners, who are mostly young people, are obviously victims of this development. In fact, homeowners can sell their house and reinvest the money in a new home, but first time homeowners lack a sufficient down payment.

An expected bubble

The force of this increase in prices and the continued growth of the activity observed in most countries for more than a decade show that the question of a real estate bubble was an issue before the financial crisis became fully blown. The downturn was expected and the only questions related to its likely duration and magnitude. In the United States, households who

were sold mortgages they were unable to repay found themselves in default. When the anticipated increase in prices gave way to a decline in the value of homes the mortgagees were no longer sufficient to compensate the creditors and the creditors found themselves in difficulty. The economic crisis followed the financial crisis; those who have lost their jobs have joined the ranks of those who are unable to cope with their commitments. Repossessions and evictions push the price of housing down, causing more borrowers to default, which in turn further depresses the market, in an apparently unending cycle. In every country most of the credit institutions, in search of high return, had taken mortgage backed securities (MBS) and indirectly lent money to Americans borrowers. As soon as the bad debts ceased to be traceable within the packages of MBS, suspicion extended to all banks, driving the global financial system into turmoil. The French bankers have been no exception and have not been spared from the general mistrust towards mortgage-lenders and more generally towards banks themselves. This financial crisis has resulted in a housing market meltdown following just over a decade of price increases.

In the United States the downturn has triggered the subprime crisis, whereas in France the slowdown began before the effects of the subprime crisis were felt. The deceleration of prices began in 2007 and was observed in some locations since the beginning of 2008. The global financial crisis has transformed what was a slowdown in the housing market into a full-blown global economic crisis.

Insolvency and negative equity

Borrowers face different kinds of difficulties. In every country they can have difficulty in meeting their repayments, or they may face such difficulties in the future, mainly linked to unemployment. This insolvency can also result from the amortization plan of the loan. This very situation has occurred mostly in the United States in cases where teaser rate loans were sold. These are 30 years ARM loans with a lower fixed rate for the first 2 or 3 years and a reset after. Thus the monthly payment goes up in the third or fourth year.

There is also the separate problem of borrowers who are in negative equity, which means that their outstanding debt is higher than the value of their home. Most of the people with loans “under the water” are often simultaneously in default. For home owners it makes moves less easy to complete in cases where they need to relocate, for instance to find a new job. The British Council of Mortgage Lenders estimates that 900,000 owner occupiers are now in negative equity.

European government’s answers

That is why most governments have introduced or considered introducing schemes aimed at helping borrowers for social purposes and also in order to avoid repossessions which will in turn push down the prices and depress the market. In every country the aim of these schemes is identical: to allow the household in the process of becoming a home-owner to continue with his mortgage or if that has proven impossible, to find a way to maintain him in his own home as a tenant.

The first method is to lower the level of the monthly payment thanks to a kind of loan deferment, for one or two years. Three questions must thus be addressed: who supports the risk linked to this deferment? Who pays the interest during the deferment duration? Is it possible to systematically avoid the penalties exigible by the borrower in cases of temporary defaults?

The second way is what is called the mortgage rescue. In this scheme the home is sold, totally or partially, to something like a housing association, and the borrower can remain in his own

home but as a tenant. If his situation improves, he can buy his home back. France and UK used this kind of scheme in the eighties.

Some precautions must also be mentioned whose goal is to encourage lenders to avoid repossessions.

The main difference among countries is the level of public involvement in the way these schemes are enforced.



II. The risk factors for home-owners

But how then can one explain the fact that in some countries borrowers are in trouble while in others they are not affected? Leaving aside the irregularities, for example the failure of the ratings agencies or examples of sordid behaviour, such as the false statements made by some brokers, that should not distract our attention from the essential reasons linked to the logic followed in recent years; the conclusion is common sense. A close comparison of the housing markets of these seven countries leads us to focus on the following three issues:

- the balance between tenures in the housing market and the level of indebtedness ;
- the organisation of the chain of credit ;
- the regulation of financial products.

| The balance between tenures in the housing market and the level of indebtedness

In Germany the demand for housing is broadly satisfied, the rate of owners being among the lowest in Europe and the rate of residential indebtedness (mortgage debt in relation to the GDP ratio) being also low. The Netherlands have a very high level of indebtedness but a low rate of homeowners. Canada presents a contrary example: the percentage of owner-occupiers is high, 68%, but the mortgage debt on GDP ratio is of a medium level, 45.6%. Italy has more than 80% homeowners but less than 20% are mortgagors. In these three countries, as in France, the property crisis has not destabilized the current mortgagors.

The situation is different in the United States, Great Britain and Spain which have a high, even very high, rate of homeownership and a high percentage of residential mortgage loans, therefore defaults and foreclosures are skyrocketing. The case of Spain is interesting since the absence of rental housing stock has led most households toward homeownership. Although it has one of the higher proportions of officially vacant homes, a huge number of which are newly built flats, it is very difficult for young people to find a dwelling and they therefore remain longer in their parental home. The level of construction has been rapidly increasing, however, all these new flats have to be sold for homeownership (or as holiday homes), not for rent. Prices and indebtedness grew at the same pace.

The percentage of mortgagor households is 45% in the United States, 40% in the UK and 20% in the euro area.

This analysis should also take into account the global level of indebtedness, totalling mortgage debt and consumer credit. In countries which practice net equity withdrawal, mortgagors can take advantage of the growing gap between the value of their home and their outstanding debt to finance consumption spending. That way most consumer credit is tied to the mortgage credit. This is a common practice in the United States, the UK and the Netherlands.

In the other countries, mortgage and consumer credit should be added to evaluate the indebtedness of households. Consumer credit can be sufficient to destabilise the tightened budget of a mortgagor. In France, where a special scheme exists to help over indebted households, only 8% of these households have a mortgage, whereas 40% had one in the early 1990s.

This brief overview shows that borrowers are more fragile when they are in countries which simultaneously have a high proportion of homeowners and a high level of indebtedness.

	% of home owners 2007	Residential mortgage debt to GDP Ratio 2007	Defaults and repossessions
France	56.50%	34.90%	No increase 2008 / 2007
Germany	43.20%	47.70%	No increase 2008 / 2007
Spain	86.30%	61.60%	High increase 2008 / 2007
United Kingdom	70.00%	86.30%	High increase 2008 / 2007
The Netherlands	54.00%	100.00%	No increase 2008 / 2007
United States	71.00%	71.00%	High increase 2008 / 2007
Canada	68.00%	45.60%	No increase 2008 / 2007
Italy	80.00%	19.80%	No increase 2008 / 2007

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

However, the legal balance of rights between tenants and owners is also important. Let us take two examples. The Spanish association of mortgage lenders would like to rent unsold flats (more than 500,000 units). They would also like to maintain in their flats, as tenants, defaulting borrowers, possibly on a temporary basis. They pretend to be unable to do for several reasons. In their opinion, Spain lacks a convenient legal framework to govern the relationship between landlords and tenants. Sale costs and legal fees are too high to make repossessed properties available for renting on a temporary basis.

The UK provides a different example: sales are easy and legal costs are low, but the protection given to the tenant is among the lowest in Europe. Therefore, some unscrupulous investors have bought the home of insolvent borrowers, taking their mortgage, and leaving them in the flat as tenant, but with a short term lease. This kind of lease allows the landlord to get rid of the tenant whenever he wants to, which could be at the first opportune moment. The government intends to forbid this practice¹.

The crisis has proven that the balance between different types of tenures can be a stabilizing factor, particularly if fluidity between tenure is easy and if taxes and fees are not too expensive at each sale.

The crisis does not undermine the policies fostering home ownership, but it emphasises that households must have the choice between several tenures, which means that a balanced

distribution of housing between ownership, the social rental sector and privately owned rental sector is a stabilizing factor, especially if the fluidity between tenures is not too expensive.

| The workings of the mortgage process

The way mortgages are sold, serviced and financed plays an important part in the risk taken by households. Key issues are who originates the loan, who services it, and who supports the loss ?

The unbundling of the constituent parts of the mortgage process

The unbundling of the chain of credit, whereby each stage of the mortgage process is done by a separate institution - the broker, who sells the credit, the originator, who keeps the relationship with the borrower, the servicer, and the investor, who bears the mortgage-backed securities - is also a factor lightening the responsibility of the lender. The originator has less incentive to avoid risk so long as it will not have to manage it and thus not suffer from future defaults. In this way the originator is acting as a broker. Moreover, the absence of any link between the mortgagee and the mortgagor prohibits any negotiation on the amortization of the mortgage, negotiation which may benefit both parties. The issue is not to know whether universal banks, “bread and butter banks”, are safer than specialized mortgage lenders, the latter usually being less restrictive, but to know if the originator will suffer or not from the consequences of the defaults of the mortgagor. The mortgage process is unbundled in the United States and in the UK, but not in Spain, where banks retain the servicing of their loans.

The funding of the mortgages

The funding of the mortgages also plays an essential part in the level of risk supported by the borrowers. In a nutshell, the main sources for funding are deposits, securitization and covered bonds. Without entering into details that can be found in the European Central Bank report,² it is obvious that lenders will be prone to examine carefully the risks for the mortgages financed with their customers’ savings. They will be as cautious if they finance their mortgages with covered bonds, since covered bonds remain on their balance sheets. However, securitization can free them from the constraints of the ratio between the volume of loans and their own corporate funds. Securitization also frees them from constraints linked to the maturity of the mortgages.

To judge whether the originator keeps a share of the risk in his balance sheets, or whether he is freed from the consequences of the borrower’s default a distinction must be made between several types of securitization. In “true-sale securitization” if the originator does not keep subordinated tranches of risk he can transfer the risk to the borrower. There is no real incentive for the originator to pay attention to the risk. This way a loan, even a very risky one, can be sold to a borrower as long as it can be resold to the market. The originator can take risks without sharing them with the borrower or the investor. The investor is supposed to evaluate the risk: thanks to the notation agencies, it has often been poorly done.

It proved to be impossible to find detailed figures about the way mortgages were funded in each of our sample countries. During the last decade the share of securitization and covered bonds in the funding of mortgages has increased alongside the increase in prices and the number of transactions. Securitization accounts for more than 50% of the funding of mortgages in the United States and 27% in the UK,³ but for only 7% in the Euro area. This proportion grew very quickly in Spain, reaching 31% in 2007 to which 15% of covered bonds must be added. The amount securitized has grown at a pace of 65% a year during the last decade and this growth has enabled the housing speculation fever. In 2007 Spain issued about

50% of all the mortgages securitized by bankers in the Euro area. Across the EU, the proportions were 60% from deposits, 17% from covered bonds and 17% from securitization⁴. However, it is hopeless to try and get precise figures about the different kinds of securitization.

The intervention of external insurance or a guarantee fund

A slice of the risk, or the whole risk, can be taken by a mortgage insurance company, which is distinct from the lender. The guarantee funds can play the same role when the government wants to foster homeownership for a type of household, for whom it would be difficult or costly using the mainstream market methods. In cases of default or repossession the lender's loss is supported, in part or in full, by the insurance or the fund. That is, roughly, what the French FGAS, the American Federal Housing Administration (FHA), the Dutch Stichting Waarborgfonds Eigen Woningen and the Canadian Mortgage and House Association are doing. As they are risk specialists, one would expect these organizations to regulate the loans and check the risk.

The experiences of the FHA and the one of the "monoline" (private mortgage insurances) are not convincing. The FHA, which aims to ensure the provision of mortgages to lower income households, imposes extremely strict standards for the loans it insures. Therefore it has not insured subprime mortgages, but its activity has been marginalized: the Republican administration did not adjust its parameters to take into account the fact that housing prices had risen a lot. Moreover, the constraints for the lenders were not balanced by the advantages offered by the public insurance. When it comes to the private mortgage insurances, their evaluation of the risks was so poor that many of them went bankrupt.

On the contrary, the Canadian experience has been a success, with 68% of home owners having a low rate of default, which has not increased in 2008. This is perhaps because it is mandatory: Canada requires mortgage insurance where the LTV (loan to value ratio) is higher than 80%. This insurance is supplied by various companies, but the main one is the Canada Mortgage and Housing Corporation. This leads to applications for mortgages being very seriously controlled. Thus a guarantee fund can be a useful tool if, alongside securing the lender, it also secures the borrower, and if it controls the entire mortgage chain for low and middle income households, regulating the financial products geared towards low and middle income borrowers.

| The regulation of mortgage products

The regulation of mortgage products, which were held by some to be counterproductive, proved, in particular in France, very efficient in closing all the loopholes that were exploited during the crisis. Regulation is also difficult to bypass.

Let us take the example of equity withdrawal. This form of active debt management leads to deferral of the loan repayment and maintenance of the level of outstanding debt. If housing prices fall, the outstanding debt of the borrower who has reloaded his mortgage quickly may exceed the resale value of his home; the creditors may see the value of their whole portfolio in negative equity, therefore decreasing the amount of new loans which they can grant because of the mark to market rules. The practice of net equity withdrawal is regulated by national law. Such a law was introduced in France in 2006 with a Gallic twist, which prohibited revaluing homes given as collateral when house prices were increasing. This choice limits the development of this new financial product since borrowers cannot take advantage of rising house prices to increase their spending. On the contrary, this encourages borrowers to pay off mortgages regularly and quickly and it reduces the global level of household's debt. That is why negative equity is not (or not yet) an issue in France. It is a political choice aimed at securing and enshrining the home and its value.

The same observations could be made respectively for the various characteristics of the mortgage: maximum loan to value ratio, fixed or variable rate, with or without security cap for low income borrowers, teaser rate loans, duration of the loans, prepayment penalty, usury law, and all the consumer protection rules.

Currently the mortgagors who face the most severe problems are those who have taken variable rate loans. It is important to note that, in the United States, the mortgages sold to the subprime borrowers were the very loans that were forbidden by the FHA. The FHA only insures fixed rate loans with no prepayment penalty.

Moreover, regulation can forbid the sale of dangerously risky products or can make it impossible to fix a price that can fit with abnormal risk: this is one of the effects of the usury law in France. However, that kind of regulation does not necessarily make sense on an international basis. For instance, in the UK the Financial Services Authority (FSA) has considered setting a maximum LTV, whereas in France, it is easy and it can be safe to take a 100% LTV mortgage.

	France	Germany	Spain	Great Britain	The Netherlands	United States	Canada
Net equity withdrawals	No	No	Legal since 2008 but not utilised	Yes	Yes	Yes	Yes
Characteristics of the mortgages	Fixed rate, < 30 % adjustable rate	Fixed rate over 5 year up to 10 years, with negotiation for the subsequent 5 year term.	Mostly variable rate	50/50 but the share of fixed is increasing	65% fixed rate Fixed rate over 5 year up to 10 years	Mostly fixed rate, but adjustable rate are increasing	Rollover" mortgage loan with fixed long-term maturity and interest rate adjusted every five years
Risk tariffication : 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	Usury rate but at 60 ! 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

Nevertheless, it proves that governments retain full latitude to define the legal and regulatory environment governing the housing chain and more specifically the supply of credit for housing.

A special mention about housing counselling

Even the lenders, in the current situation, seem to be convinced of the necessity of giving advice, separate from the information that they themselves or the builder can give to their customers. Robert Shiller, a leading authority who predicted the crisis, in his most recent book called for the creation of an information system geared towards low income households. Housing counselling enables the low income home-buyer to be aware of the real extent of his commitments, in the long run. It helps the borrower to study his project and to shop around for the best mortgage. It helps the lenders to assess the ability of the borrower to repay and secures the lenders' guarantee. It avoids social difficulties in helping the delinquent or over-indebted borrower. In France, housing counselling is the purpose of ANIL / Agence Nationale pour l'Information sur le Logement (or National Agency for Housing Information)⁵. It can be observed that counselling, seen in France as a way to protect consumers, can also be considered as an instrument for increasing the quality of the debts in question in the eyes of the mortgagors⁶.



III. What kind of home ownership policies after the crisis ?

The crisis does not undermine the policies fostering home ownership, but it emphasises that households must have the choice between several tenures, which means that a balanced distribution of housing between ownership, the social rental sector and privately owned rental sector is a stabilizing factor, especially if the fluidity between tenures is not too expensive. We must therefore consider the two main issues of home-ownership policies: making home ownership affordable and providing access to credit to these households. In relation to both of these aims the current crisis leads us to re-evaluate the efficiency of the ways and means used by governments. The efficiency of affordability policies is linked more and more to the global financial situation, but the legal rules which define the mortgage process remain very efficient.

| Affordability policies: efficiency depending on international rate variations.

A diversity of tools

The means used to help borrowers to meet their payments are diverse, but all fall into one of the following categories: tax incentives, housing benefits, various types of grants, shared ownership and subsidized loans. France uses all of these: tax reduction for borrowers, housing benefits, grants given by some local authorities, property shared between leaseholders and homeowners, and subsidized mortgages.

Effectiveness is reduced by rising housing prices

The actual amount of these types of grants must be related to the price of houses; this ratio varies with the variation in housing prices, thus also with the fluctuation in interest rates. To take the French example: in the first instance, interest rates went down and the length of the mortgage increased, resulting in an increase in the affordability of houses, and an increase in the production of new houses. With the same financial burden (in terms of the ratio of mortgage debt payment to income), a household could in 2006 borrow twice the amount than in 1996. Thus the public grant could appear to be useless but then, progressively, rising house prices reduced the affordability and the effect of these grants. To take the example of the 0% loan for newly built houses: its effect was reduced by 50%. Its actual value was around 10% of the cost of the house in 1996 compared with 4% in 2006. In spite of this loss of effectiveness the parameters of this loan remained unchanged. Today governments must

realise that their actions are subject to the impact of international financial conditions but that they have no influence over these conditions.

Policies criticized for lack of efficiency or for lack of justice

Thus, affordability policies cannot be considered as structural any more. It is especially true of assistance given to a majority of borrowers. A good example is the US tax reduction, which is given to all borrowers. Most American experts think that it has encouraged levels of indebtedness but has had no impact on the housing market, since any effect has been subsequently integrated in the housing prices. That is also the reason why it is difficult to suppress it. Another criticism focuses on the efficiency of this aid on one the hand and the equity of it, on the other. To what extent do these forms of assistance fuel the rise in house prices? To what degree does the assistance trigger the beneficiaries' actions, or is it the case that they would have acted in the same manner regardless of the help received? In areas where house prices are high, is it only young professionals who have inherited wealth that can afford the down payment? It is always difficult to reach an agreement regarding how effective the assistance policies are, which is why one is often content to simply point to the number of beneficiaries of particular policies.

Towards more targeted policies

However, public policies can be directed towards smaller categories: first time homeowners, certain types of families, specific geographical areas, or certain types of projects. One then has to consider how the assistance reduces the affordability gap between households who receive this aid and households who cannot benefit from it. In order to take account of price changes, over which European States have less and less power, these policies should be adjusted frequently and should be geared towards precise targets. Government will have to change from autonomous long-term policies to national policies reactive to the global environment. They will have to continuously adjust their policies to the vagaries of international financial conditions. This leads one to imagine that governments will have to direct their policies towards more precise and/or more day to day targets. It will be very difficult because governments must also take account of other factors, such as the macroeconomic impact of assistance policies. The French stimulus plan provides a good example of this, since temporary assistance, targeted at newly constructed houses for first time homeowners, has been set at such high levels that the assistance can equal more than 40% of the total cost of the construction.

Unemployment safety nets

The efficiency of these schemes cannot be evaluated without taking in account the social protection against unemployment in each country. Let us quote the classification of Jean-Philippe Cotis: in the American system the level of indemnities for unemployment is low and protection of employment is weak, but redundant workers spontaneously find a job quickly. In the Nordic system, indemnities for unemployment are generous, help given to the redundant worker to find a new job is very active and efficient. In the French system, indemnities are rather generous, help to find a new job inefficient and the duration of unemployment is long.

| Access to credit: more regulation of process and products

Schemes that split the link between the mortgagee and the mortgagors should be avoided. Moreover they result in the untraceability of risks and prohibit any negotiation on the amortization of the mortgage, negotiation which may benefit both parties, and long running operations must be allowed flexibility with which to address unforeseen events.

Schemes that allow the originator to externalize the risk and be freed from the consequences of the defaults of the borrowers should be forbidden. Otherwise he will have no incentive to pay attention to the risk. In addition, it goes against the principle of transparency, which is essential for a market economy. Access to housing counselling, independent from the lender must be free, at least for low-income first time home owners. Products and process must be regulated; dangerous products should be forbidden. Guarantee funds, which guarantee lenders, could regulate products aimed at low and middle income borrowers and also, to some extent, guarantee mortgagors. Even in a global economy, governments retain full power to regulate the products and the consumer protection, all rules that are very difficult to bypass.

A halt to the integration of the European mortgage market?

However, products regulation and consumer protection issues are major stumbling blocks in European negotiations towards a more integrated mortgage market. What are the benefits expected by the European Commission of an integrated mortgage market? The London Economics survey “estimates that increases in product availability, resulting in the same mortgage products becoming available in all countries, would achieve most of the benefits of full mortgage market integration. We estimate that an increase in product availability alone would increase EU consumption by 0.4% and EU GDP by 0.6%. Increases in product availability would have this effect by increasing consumers’ demand for mortgages and thus for housing. Young borrowers might move from their parents’ house or rented to owned accommodation, but the key point is that we expect increased product availability to have the net effect of increasing the total demand for housing⁷. The role of abundant, non-restrictive and inexpensive credit in the genesis of the crisis prompts one to doubt of the soundness of these objectives.

As to the major obstacles which must be overcome in order to achieve this integration, they are the legal framework which defines the products as lawful, information and the protection of the consumer. For a country such as France, we should desist from the present very high level of consumer protection. According to the London Economics Survey for the European Commission, an integrated European market should have rules similar to the British ones. However, the latter is not of universal value, it reflects a political choice consistent with the preferences and attitude of the British people with regard to home ownership and risk.

The French have never been at the forefront of this struggle for a better integration of the EU mortgage market; there was a kind of “holy” alliance in Brussels: French lenders supported consumer associations in the defence of “rights acquired” by consumers: they protected themselves against competition from other countries’ lenders. The current financial crisis does not give grounds for the acceleration of the integration process. On the contrary, it emphasises the necessary overlap between policy makers, in charge of the housing policy, and those who define the legal characteristics of the homeownership process and mortgage supply. Would an integrated mortgage market, even regulated, have proved more efficient in stopping the global financial turmoil? On the contrary, some countries can congratulate themselves for having maintained the rules which have limited the consequences of the financial disorders. The postponement of the integration of European mortgage markets will perhaps be among the collateral damage from the subprime crisis.

Bernard VORMS



Appendix / The schemes designed in European countries to help troubled borrowers

The efficiency of the schemes designed by European governments to help borrowers in trouble cannot be evaluated without taking in account the social protection against unemployment in each country. Jean-Philippe Cotis proposed the following classification: in the American system the level of indemnities for unemployment is low and protection of employment is weak, but redundant workers spontaneously find a job quickly. In the Nordic system, indemnities for unemployment are generous, while the help given to the redundant worker to find a new job is very active and efficient. In the French system, indemnities are rather generous, help to find a new job inefficient and the duration of unemployment is long.

While this classification is useful, we must nevertheless describe the schemes designed or still active in some European countries. Their very existence proves that it is a concern shared by a majority of governments⁸.

| Protect the mortgage if possible, at the least maintain the household in the home

In every country the aim of these schemes is identical: to allow the household in the process of becoming home-owner to continue with his mortgage or if that has proven impossible, to find a way to maintain him in his own home as a tenant.

The first method is to lower the level of the monthly payment thanks to a type of loan deferment, for one or two years. Three questions must thus be addressed: who supports the risk linked to this deferment ? Who pays the interest during the deferment ? Is it possible to systematically avoid the penalties exigible by the borrower in case of temporary defaults?

The second way is what is called the mortgage rescue. In this scheme the home is sold, totally or partially, to something like a housing association, and the borrower can remain in his own home but as a tenant. If his situation improves, he can buy his home back.

France and UK used this kind of scheme in the eighties.

Some precautions must also be mentioned whose goal is to encourage lenders to avoid repossessions.

The main difference among countries is the level of public involvement in the way these schemes are enforced.

The schemes set by European countries

Spain

- *Lowering of the monthly payments*

Borrowers who have lost their job since September 2008, with mortgages under €170,000, can defer 50% of their monthly payment, with a ceiling of €500 over 2 years, which was extended to 3 years since February 2009.

Borrowers pay the additional interest, but the State bears the risk linked to the deferment.

- *Mortgage rescue*

The representative body of the Spanish mortgage lenders would like the lenders themselves to buy the house, possibly for a short term, maintaining the borrower as tenant. For that reason they would like a quick and cheap procedure to repossess the home, a procedure that would allow them to avoid legal fees and taxes for every sale.

United Kingdom

- *Lowering of the monthly payments*⁹

- *Income Support for Mortgage Interest (ISMI)*

Since 5 January 2009, homeowners will only have to wait 13 weeks, instead of 39 weeks, to be eligible for support. This is broadly in line with the three month limit after which time banks would consider mortgage payments to be seriously in arrears. As a temporary measure, from 5 January 2009, the capital limit for loans on which ISMI is based was increased to from £100,000 to £200,000.

In the Pre-Budget Report, the Chancellor also announced that the Government would "maintain the level of support at the current interest rate for the next six months for existing claimants so that net support to such claimants is increased". The reforms to ISMI have been well received; although, again, there have been suggestions that their scope is too limited. The Intermediary Mortgage Lenders' Association states that "the extensions to the ISMI scheme are important and helpful but the scheme still remains restrictive". The Council of Mortgage Lenders argues that "coverage for around 10,000 potential claimants does not go far enough in an environment of rising unemployment". The scheme does exclude some households who could reasonably be viewed as entitled to some support, for example households where a mortgage is predicated on two incomes, since these "will see their entitlement to ISMI heavily reduced or negated through means testing". It also excludes households experiencing a reduction in, rather than total loss of, income, perhaps through lost overtime.

- *Homeowner Mortgage Support Scheme*

Households that experience a significant and temporary loss of income as a result of the economic downturn are able to defer a proportion of the interest payments on their mortgage for up to two years. The Government will guarantee the deferred interest payments in return for banks' participation in the scheme. It is intended by the Government as a "bridge through difficult times". To date the eight biggest lenders, representing 70% of total lending, have pledged to work with the Government to implement the scheme. The Homeowner Mortgage Support Scheme differs from the ISMI scheme because of the requirement that the home owner repays the financial support given at a later date.

- *Mortgage rescue*

- *Shared equity*

A housing association provides an equity loan enabling a household's mortgage payments to be reduced. This option is designed to assist homeowners who have an equity share in their home and are facing a payment shock from remortgaging and/or higher living costs but who are likely to retain their current income.

- *Government mortgage to rent*

A housing association pays off the entire mortgage and the householder pays rent to the housing association at a level they can afford. This option is designed to assist homeowners who are unable to meet lenders' requirements, perhaps because their income is unstable, and households which are more suited to social tenancies.

Regulation against speculative buy-to-let

Several submissions described the problems which occurred in the hitherto unregulated private sale-and-rent-back sector, including early eviction or unsustainable rent increases by unscrupulous landlords. Some people have sold their home to a sale-and-rent-back landlord only to find themselves evicted because the landlord has defaulted on the mortgage. This area

was the subject of a recent Office of Fair Trading market study. It recommended that "sale and rent back transactions be subject to statutory regulation, and that this be carried out by the Financial Services Authority".

Ireland

The lenders code of conduct for the defaults, which was voluntary, became mandatory in February 2009. It forbids lenders to begin a repossession action before there have been 6 unpaid monthly payments.

Italy

- *Lowering of the monthly payments*

Every borrower – there is no set income or house price ceiling – in case of unemployment is entitled to get 18 monthly payments without amortization. The cost of this deferment is paid by the State.

Portugal (not yet published)

- *Lowering of the monthly payments*

In case of unemployment, 50% of the monthly payments are deferred for 2 years.

The repayment will take place during the rest of the amortizing period.

- *Mortgage rescue*

A kind of mortgage rescue will be practiced by a dedicated “*fundos des investimento imobiliario para arrendamento habitacional*”, the details of which are still under negotiation.

United States

The difficulties faced by Americans are unique and the legislation changes from one state to another. Some problems are due to the type of teasing loans which were sold.

Moreover the kind of true-sale securitization used and the fact that many borrowers have several loans, first lien and piggy-back loans, rules out any possibility of negotiation between borrowers and borrowees.

The Treasury failed in trying to enforce some kind of mitigation policies: first lien loans and piggy back loans are not in the hands of the same investor.

France

France is currently working on a plan to help home-owners who may experience a significant and temporary loss of income as a result of unemployment. The efficiency of this policy will be a test for the future home ownership and mortgage chain.

ANIL, the National housing information board, will publish a comprehensive document on housing counselling geared toward borrowers in trouble. For the time being, default rates have not gone up, but ANIL must be prepared to help households to face the consequences of unemployment.

¹ Cf. BBC Money facts.

² Housing finance in the euro area, mars 2009.

³ Source : FSA ; The Turner review, mars 2009.

⁴ Source : EMF/European mortgage federation.

⁵ See appendix 1 or <http://www.anil.org>

⁶ See. Abdighani Hiram and Peter M. Zorn, "A Little Knowledge Is a Good Thing : Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling".

⁷ The costs and benefits of integration of EU mortgage markets. Report for European Commission, By London Economics August 2005.

⁸ Thanks to Christine Whitehead and Kath Scanlon from the London School of Economics.

⁹ Source : <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/101/10107.htm>.