The global financial system and national housing markets

How can public policies foster homeownership following the crisis?

The present economic crisis provides a timely opportunity to assess the objectives of the governments' housing policy and the effectiveness of the means used by the public authorities for the implementation of these policies. These reflections cannot be oriented towards immediate application, since in the short term ensuring employment will be the primary concern. The financial crisis has provoked a property crisis all over the world; however, the repercussions have been very different from country to country. How can these differences be explained? What can be learned, in relation to the soundness of public policies fostering home ownership and regarding the ways and means used by governments in a globalized economy? The question must also be asked whether this crisis provides the opportunity to accelerate the integration of the European mortgage markets.

The global housing crisis

The spread of the American housing crisis

Although the American housing crisis was not anticipated, it appears with the benefit of hindsight to have been inevitable. Households who were sold mortgages they were unable to repay found themselves in default; how could it be otherwise? When the anticipated increase in prices gave way to a decline the value of homes sold to pay the mortgagee 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 default¹, 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\(^2\), 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.

### Excess 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, commercial Asian surpluses and oil producing countries’ surpluses, resulted in the lead prices of all assets going up, interest rates falling and the level of indebtedness rising.

For France, the history of the regulated loan for housing (prêt conventionné) rates 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

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</thead>
<tbody>
<tr>
<td>France</td>
<td>5.60%</td>
<td>5.90%</td>
<td>6.40%</td>
<td>5.40%</td>
<td>5.10%</td>
<td>4.40%</td>
<td>4.25%</td>
<td>3.50%</td>
<td>3.90%</td>
<td>4.60%</td>
</tr>
<tr>
<td>Germany</td>
<td>5.29%</td>
<td>6.40%</td>
<td>6.44%</td>
<td>5.87%</td>
<td>5.52%</td>
<td>5.14%</td>
<td>4.63%</td>
<td>4.19%</td>
<td>4.64%</td>
<td>5.03%</td>
</tr>
<tr>
<td>Spain</td>
<td>4.90%</td>
<td>4.40%</td>
<td>5.90%</td>
<td>4.50%</td>
<td>3.80%</td>
<td>3.18%</td>
<td>3.30%</td>
<td>3.50%</td>
<td>4.03%</td>
<td>5.06%</td>
</tr>
<tr>
<td>Great Britain</td>
<td>6.12%</td>
<td>5.98%</td>
<td>5.19%</td>
<td>5.48%</td>
<td>4.58%</td>
<td>4.18%</td>
<td>5.04%</td>
<td>5.23%</td>
<td>5.10%</td>
<td>5.75%</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>5.30%</td>
<td>6.00%</td>
<td>6.40%</td>
<td>5.50%</td>
<td>5.20%</td>
<td>4.90%</td>
<td>4.80%</td>
<td>4.11%</td>
<td>4.37%</td>
<td>4.96%</td>
</tr>
<tr>
<td>United States</td>
<td>7.05%</td>
<td>7.11%</td>
<td>8.05%</td>
<td>7.09%</td>
<td>6.59%</td>
<td>5.37%</td>
<td>5.91%</td>
<td>6.66%</td>
<td>6.55%</td>
<td>6.19%</td>
</tr>
<tr>
<td>Canada</td>
<td>6.93%</td>
<td>7.56%</td>
<td>8.35%</td>
<td>7.84%</td>
<td>7.02%</td>
<td>6.39%</td>
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</tbody>
</table>

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, the housing prices increased by a factor of 2.5 between 1996 and 2007; a higher pace 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.

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</thead>
<tbody>
<tr>
<td>France</td>
<td>2.9%</td>
<td>7.5%</td>
<td>7.9%</td>
<td>8.1%</td>
<td>9.0%</td>
<td>11.5%</td>
<td>17.6%</td>
<td>14.7%</td>
<td>9.9%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.8%</td>
<td>0.0%</td>
<td>-1.6%</td>
<td>-0.8%</td>
<td>-0.8%</td>
<td>-1.7%</td>
<td>-0.9%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>Spain</td>
<td>5.8%</td>
<td>7.7%</td>
<td>8.6%</td>
<td>9.9%</td>
<td>15.7%</td>
<td>17.6%</td>
<td>17.4%</td>
<td>13.9%</td>
<td>10.4%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Great Britain</td>
<td>10.9%</td>
<td>11.5%</td>
<td>14.3%</td>
<td>8.4%</td>
<td>17.0%</td>
<td>15.7%</td>
<td>11.8%</td>
<td>5.5%</td>
<td>6.3%</td>
<td>10.9%</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>11.7%</td>
<td>16.2%</td>
<td>16.5%</td>
<td>11.2%</td>
<td>8.5%</td>
<td>5.0%</td>
<td>4.3%</td>
<td>4.3%</td>
<td>4.7%</td>
<td>4.2%</td>
</tr>
<tr>
<td>United States</td>
<td>4.75%</td>
<td>7.43%</td>
<td>8.60%</td>
<td>9.27%</td>
<td>7.99%</td>
<td>10.6%</td>
<td>12.1%</td>
<td>15.7%</td>
<td>11.5%</td>
<td>-2.1%</td>
</tr>
<tr>
<td>Canada</td>
<td>3.79%</td>
<td>3.70%</td>
<td>4.73%</td>
<td>9.90%</td>
<td>9.73%</td>
<td>9.28%</td>
<td>10.09%</td>
<td>11.12%</td>
<td>10.97%</td>
<td></td>
</tr>
</tbody>
</table>

Source FHE

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 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.
The impact varied widely depending on the country

While most real estate markets have been affected, the manifestations of the crisis have not been identical in all countries.

The troubles of the American subprime lenders had prompted the French banks to reconsider, somewhat, their risk policies, even before they themselves had to confront very serious liquidity problems. They have focussed more on the soundness of the operations they finance and have been more cautious towards borrowers whose employment seems tenuous.

The supply of very long term loans (>25 years) was reduced, notably after some temporary difficulties encountered by borrowers on adjustable rates.

The lenders, however, did not need to reduce the credit supply, although they have been accused of doing so, because the demand shrunk significantly.

The slight increase of rates has led to the lower income would-be creditors being rejected (their solvency was reduced by about 10% between the end of 2006 and the beginning of 2008), the economic crisis has scared off others, the operations of simultaneous resale and purchase have become difficult (the availability of high percentage LTV bridge loans have been reduced), but it is particularly the hope of a further drop in prices and the fear of the economic crisis which have led most potential borrowers to adopt a wait and see approach, which itself extends the decline.

However, at no time has the behaviour of lenders been motivated by a rise in the number of defaults on ongoing mortgages. In France the gravity of the property crisis, (in the fourth quarter 2008 almost 15,000 homes were sold, 47.6% less than in the fourth quarter 2007), was not the result of disorder within the housing market: there is neither overproduction - the few unfortunate buy-to-let investments are very localized - nor over-indebtedness.

That is why there are not the same phenomena which are accompanying the housing crisis the United States, Great Britain or in Spain: the rate of defaulting borrowers has not yet increased and the number of foreclosures has remained very low. The current mortgagors are not, yet, in trouble.

Neither the rate of defaults, nor the number of repossessions has increased in 2008 in comparison to 2007. The difficulties will probably come later, but this will be caused by the economic crisis and the rise in unemployment.

For the time being, Germany, the Netherlands, France, and even Canada appear to be avoiding a rise in the number of defaults and repossessions.

To explain the difference one could say that in these countries the housing crisis has not arisen from a rising insolvency among borrowers and that it has not had the effect of destabilizing borrowers.

Why have some housing markets been more resilient?

If this disparity is not merely a question of delayed effect, how then can the fact that housing markets in some countries are in a better shape than in others be explained? The answers are to be found on the one hand in the housing market itself and on the other hand in the functioning of the chain of credit.

It is necessary firstly to distinguish between the various phenomena that have been identified as the causes of the current crisis, which do not necessarily occur simultaneously.

\[1\] Examples were taken among seven countries: Germany, Spain, UK, Nederlands, USA, Canada and France
The constituent elements of the crisis

Let us analyse the main causes of this crisis, 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, which should not distract our attention from the essential reasons linked to the logic
followed in recent years.

a) The excess liquidity in the world has caused a reduction in rates and an increase in the price of
housing.

b) Securitisation has helped to liberate the lending institutions from the regulatory constraints of
capital, allowing them to accumulate greater volumes of debt.

c) The manner in which the securitization was done by cutting the loans in opaque slices of risk, has
meant that it is impossible to trace the risks and has subsequently ruled out any renegotiation of the
outstanding loans.

c) Mortgages were offered to risky, subprime clients without proper risk analysis.

d) Toxic loans were sold, the reimbursement of which was predicated on the occurrence of
uncertain events: the increased income of the borrower, rising house prices or even higher yields on
buy-to-let investments.

The combination of these phenomena explains the seriousness of the crisis, but not all were
necessarily in play simultaneously. The credit rate has followed the same developments everywhere,
but not all countries have expanded the supply of credit to the same extent, nor traded toxic
products on the market. It is possible to sell toxic loans without securitizing them; many American
banks are in quasi-bankruptcy for having offered these types of loans while keeping them on their
balance sheet.

Therefore, it seems that the explanation of the differential reaction to the crisis in different countries
must be found in the nature of their housing stock and in the organization of their mortgage
processes.

The balance of tenures for the housing stock

The first elements to consider relate to the housing market itself: the tension within the market, the
elasticity of supply, the percentage of mortgagors and the level of residential mortgage debt can
explain the different sensitivity to variations in interest rates.

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) is also
low.

The Netherlands have a low rate of homeowners and very high level of indebtedness. 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 %.

In these three countries, as in France, the property crisis has not destabilized the current
mortgagors. The situation is different from the United States, Great Britain and Spain which have a
high, even very high, rate of owners 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. Now, with the crisis, mortgage bankers are asking the government to
improve the law regarding the relationship between tenants and landlords so as to rent repossessed houses and dwellings which are built but unsold.

### Mortgage markets fragility

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<tr>
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<tbody>
<tr>
<td>France</td>
<td>56.5%</td>
<td>20.00%</td>
<td>34.90%</td>
<td>No increase</td>
</tr>
<tr>
<td>Germany</td>
<td>43.2%</td>
<td>51.00%</td>
<td>47.70%</td>
<td>No increase</td>
</tr>
<tr>
<td>Spain</td>
<td>86.3%</td>
<td>23.9%</td>
<td>61.60%</td>
<td>High increase</td>
</tr>
<tr>
<td>Great Britain</td>
<td>70.00%</td>
<td>50.5%</td>
<td>86.30%</td>
<td>High increase</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>54.00%</td>
<td>60.80%</td>
<td>100.00%</td>
<td>No increase</td>
</tr>
<tr>
<td>United States</td>
<td>71.00%</td>
<td>52.7%</td>
<td>71.00%</td>
<td>High increase</td>
</tr>
<tr>
<td>Canada</td>
<td>68.00%</td>
<td>42.3%</td>
<td>45.60%</td>
<td>No increase</td>
</tr>
</tbody>
</table>

Sources: European Mortgage Federation National Experts, National Central Banks, National Statistics Offices, Eurostat, International Monetary Fund, and Canada mortgage and housing association.

It is not a surprise that among this seven countries, the United States, the UK and Spain are the most deeply hit. The subprime crisis triggered the crisis, the Spanish economic development was driven by the construction industry and the financial services played a major part in the British growth.

Thus, among these seven countries, those who combine a high percentage of homeowners and a high mortgage debt on GDP ratio are the most vulnerable. However, a careful examination shows that the legal playing field within the mortgage supply process plays a more decisive role when it comes to explaining the differential effects of the financial crisis on domestic housing markets.

### The workings of the mortgage process

Not all countries have sold toxic loans. In the case of France one must remember that in 2007 the issue for the public authorities was to expand the supply of mortgages and to remove the main hurdles to accessing credit for non conforming borrowers (customers with atypical profiles, due for instance to the nature or regularity of their income, their age or their state of health). The fact that the level of defaults is still very low shows that this objective was legitimate. But the high level of security of the mortgage process means that it is also very restrictive.

All French lenders keep the servicing of their loans and thus support the consequences of the defaults; therefore they have a strong incentive to avoid excessively risky loans.

General banking institutions which consider housing loans first and foremost as a way of gaining new customers and developing customer loyalty focus their attention on the customer’s ability to pay and the commercial opportunities of the relationship and attach little weight to the other side of the transaction, namely the value of the asset being financed.

Moreover, the way the usury rate is calculated, at a 30% premium to the average market rate, prohibits the setting of prices which cover both origination fees and the cost of risk for a subprime mortgage. Lastly, equity release is not practiced in France.

However, 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 may grant, because of the mark to market rules.

The French public debt is very high, but household debt remains low and France is still in the group of countries whose debt is well rated. The French State is very indebted, but this is not the case with households. One cannot speak of “easy credit”.

However, there is a strong relationship between the characteristics of the housing market and that of the credit supply.

**Completeness of the mortgage credit market**

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>Germany</th>
<th>Spain</th>
<th>Great Britain</th>
<th>Netherlands</th>
<th>United States</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Access to credit</strong></td>
<td>Rather restrictive; difficult for non conforming borrowers (irregular jobs, old people or people in bad health who cannot get death and incapacity insurance)</td>
<td>Rather restrictive</td>
<td>Rather easy access</td>
<td>Easy access to credit</td>
<td>Rather easy access to credit</td>
<td>Easy access to credit</td>
<td>Rather easy access</td>
</tr>
<tr>
<td><strong>Range of products</strong></td>
<td>Small</td>
<td>Small</td>
<td>Small range of products</td>
<td>Very large range of products</td>
<td>Large range of products</td>
<td>Large range of products</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Net equity withdrawals</strong></td>
<td>No</td>
<td>No</td>
<td>Legal since 2008 but no production</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Characteristics (2006)</strong></td>
<td>Fixed rate, &lt; 30% adjustable rate</td>
<td>Fixed rate during 5 year term, with negotiation for the subsequent 5 year term.</td>
<td>Mostly adjustable rate</td>
<td>50/50 but the share of fixed is increasing</td>
<td>65% fixed rate</td>
<td>Mostly fixed rate, but adjustable rate are increasing</td>
<td>“Rollover” mortgage loan with fixed long-term maturity and interest rate adjusted every five years</td>
</tr>
<tr>
<td><strong>Risk tariffication: maximum gap between two applicants</strong></td>
<td>Usury rate. Ceiling of 150 basis points</td>
<td>Usury rate: 12% basis points or 100% above the average market rate.</td>
<td>“no abnormal” rate, i.e. *2.5 times the legal rate.</td>
<td>No usury rate</td>
<td>No more than 16.5% above average rate</td>
<td>600 to 800 basis points above the average rate</td>
<td>Usury rate but at 60% not efficient for the mortgage loans. CMHC doesn’t use a “risk based pricing” approach</td>
</tr>
<tr>
<td><strong>Non recourse or full recourse</strong></td>
<td>Full recourse except for the mortgage guaranteed by the FGAS.</td>
<td>Full recourse</td>
<td>Full recourse</td>
<td>Full recourse</td>
<td>Full recourse or non recourse depending on the state.</td>
<td>Full recourse except in Alberta for some loans</td>
<td>Yes</td>
</tr>
</tbody>
</table>
### Organisation of the mortgage supply chain

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

### Policies which foster homeownership

In many countries governments have attempted to increase the proportion of home-owners. The motivations are always the same: it is the preference of households, it results in a lower burden for public spending, increased involvement in the community and permits the accumulation of assets in anticipation of retirement.

Our concern here is with the process of becoming a homeowner with a mortgage. The transfer, more or less for free, of the public housing stock to its tenants in the formerly socialist countries responds to another logic. It is also worth noting the policies aimed at developing the supply of land and those which govern the use of land, or which distinguish between the ownership of land and the right to construct edifices on that land.

These policies are of utmost importance but they are not especially geared toward homeownership. In France they are mainly used to force local governments to build social rental housing.

Some policies are aimed at selling social housing to the tenants thereof. The British “right to buy”, which gave the tenants of the council housing the right to acquire their dwelling, is the most radical example of this policy.
It should be noted that these types of policies depend on the law and therefore do not necessarily weigh on public finances, however, further discussion of this is beyond the scope of this paper.

Policies designed to foster home ownership must therefore address themselves in two directions: affordability and access to credit. We have to ensure that the access to credit is open to all households who have the ability to repay the credit and that the burden of repayment on those in the low income brackets should be reduced through public aid.

Until the 1990s in France specialized mortgage lenders supplied mortgages for households in the low and middle income brackets; these mortgages were often subsidised loans.

During the 1980s most European countries deregulated housing finance (that is, left it open to market influences). Today, in order to encourage mortgage lenders to lend to low income borrowers, public authorities can take a share of the risk. That is the aim of the Guarantee Fond for home ownership, in the Netherlands and France. The aim of these guarantees is to provide a kind of insurance for the lenders. It is, however, also important to secure home ownership for the households.

We must therefore consider two types of policies: one is to make home ownership affordable and the other one is to give 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.

**The effect of affordability tools and the international situation**

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 (with 0% interest rates).

The actual amount of this grant must be related to the price of houses; this ratio varies with the variation in housing prices, thus also with the variation of 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. Thus, the fact that the 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 and longer period of time. Thus, in 1996 it took 3.5 years of income for a household in the 70th percentile 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.

The effect of these affordability policies depends on international rate variations.
Thus, affordability policies cannot be considered as structural any more. It is especially true for 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 subsequently been integrated in the housing prices. That is also the reason why it is difficult to suppress it.

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. 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.

In order to take account of interest rate changes in the global market, over which individual European States are powerless, this policy 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.

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.

The aims of international regulations

Everybody seems to be calling for a new system of international regulation.... It will not reduce global levels of debt. The objective will be to limit to excesses within financial transactions, to end the avoidance of official regulation by some financial players, and to ensure transparency and traceability of debts. The USA may return to more strictly regulated mortgage products, which France never ceased to use.

However, each country must endure the consequences of the variations in interest rates, despite the fact that there is no link between these variations and their own economic policy. The alternative is for France to set as its policy a target of supporting or developing the level of activity. The government may slightly limit the impact of rate fluctuations by reducing the supply of credit borrowed from the global financial market and increasing the supply from internal resources by directing French household savings towards the banks’ balance sheets.

The deregulation has led the non-specialised banks to resort to the global market for a larger share of the money they need to offer mortgagees. 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. 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.
The efficiency of the rules governing the mortgage lending process

On the contrary, the government retains full latitude to define the legal and regulatory environment governing the housing chain and more specifically the supply of credit for housing.

Thus, in France, the law, jurisprudence and banker practices reflect societal mistrust towards credit. They are consistent with the more general protectionist tendencies within French law, which multiply the systems aimed at cushioning risk.

This attitude, although it can be viewed as restrictive, has not only benefits, but furthermore it explains the very low level of defaults in France.

Most of the dangerous or irregular practices which caused the subprime crisis could never have occurred.

Despite the globalisation of the financial system, the rules concerning the supply of credit, whether in relation to the characteristics of financial products, consumer protection, or even in relation to ‘safety nets’, proved to be efficient.

None of these rules are easily circumvented and they have proved their effectiveness. This explains the repeated failure of foreign banks to enter the French market, although they were willing to take the risks that the French lenders avoid.

Let us consider a few examples of the elements within these national regulations.

The practice of net equity withdrawal is regulated by a 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 its value. Other countries might argue that it restricts the capital owned by households by keeping it locked in their home.

The same observations could be made respectively for the various characteristics of the mortgage: minimum down payment, negative equity, teaser rate loans.

For instance Canada asks for mortgage insurance as long as 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 insurance is only mandatory for federal banks, but most banks apply it. Thus loan applications are examined very stringently.

We had a small scale scandal in France in 2007, concerning some very complicated adjustable rate mortgages. It could have been avoided had teasing loans been prohibited.

Usury law (the ceiling for the interest rate) is designed in such a way that it is impossible for above average risk to be priced or to carry out underwriting work on it.

It is forbidden by law to charge an interest rate which is 1/3 higher than the average rate for the same kind of loans. Thus the margin above the average is very small when interest rates are low (for instance, 1.33% when the average rate is at 4%, whereas you can charge 3.33% more the average, when the average is at 10%)
This rule is not very clever, since it restricts access to credit when interest rates are low! However, the principle of setting a ceiling to interest rates has proved efficient in prohibiting toxic or excessively risky loans.

Some may think this rule is too restrictive in comparison with the UK, which refused to set an interest ceiling and chose instead to emphasise market transparency, consumer information and competition among lenders.

Other rules of consumer protection force credit institutions to properly inform borrowers of the consequences of their commitments. Some have called for the establishment of a duty of counselling, which would penalise lenders who have sold a borrower a product that is not in his interest.

The example given above regarding the maturity of loans is even more significant. Specialized mortgage lenders initially presented the ‘duration of the mortgage’ not as a constraint, but as a facility afforded to the borrower which enabled him not to delay his project.

However, this development has been encouraged by the government: the regulation of contracted loans has been amended to allow this longer length.

This reform aimed to offset the increase of prices; in so doing, the State gave a clear indication of a general development which has, in the medium term, contributed to this increase.

The design of the 0% rate loan had the same aim. It would perhaps have been wiser were lower income households not restricted in their options by being tied into long-term commitments, many of which will extend for a longer duration than the period for which people will remain in the same house.

One cannot expect lenders to be against long-term loans. On the contrary, it is a development that governments would have been able to control, at least to the extent of not encouraging it for low income borrowers.

Many other examples could be given (early prepayment and all rules designed to address borrower’s flexibility).

The capping or prohibition of the early prepayment penalty may be a cost which affects the average rate of loans, but it is an element which preserves the borrower’s mobility.

The way the law is enforced in cases of default also influences credit access: the attitude of the lender will not be the same if the property can be repossessed, more or less easily, and if its guarantee is only on the collateral or extends to the whole of the borrower’s property.

When it comes to this question, in the countries that use non-recourse contracts (which means that the liability of the borrower is limited to the value of the collateral asset) it is important to know whether a borrower in negative equity, but who can meet his payments, will walk away.

The same can be said about the safety nets. If, as one may fear, unemployment increases everywhere, the number of borrowers with problems meeting their monthly payments will increase, and it will then be possible to judge the effectiveness and the speed of reaction of the various cushioning systems put in place to secure home ownership in the countries which have not seen in 2008 an increase in the number of defaults and repossessions.

However, at the moment the United States have not yet succeed in establishing schemes to help the borrowers who cannot cope with their payments, which would also have the effect of reducing the housing price tailspin.

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Also, Spanish bankers are today asking a modification of the law and a reduction of the compulsory costs (taxes and fees) induce by each sale to improve the fluidity between tenures.

As there are a huge number of unsold flats (more than 500 000 units), and lenders would like to use a simplified and inexpensive procedure to enable the defaulting borrowers to stay in their homes, albeit on a temporary basis, as tenants.

With regard to the regulation of the mortgage process, the United States provides an excellent illustration. The FHA (Federal Housing Administration), which aims to ensure the provision of mortgages to lower income households imposes extremely strict standards for the loans it insures. Fannie Mae and Freddie Mac did the same for the loans they securitised for low income borrowers. To take only one example, during the 1990s Freddie Mac and Fannie Mae bought only fixed rates loans for low income borrowers and the prepayment penalty was forbidden.

They even required housing counselling with an independent counsellor for lower income borrowers\(^6\). They have subsequently been allowed to enlarge the scope of their activities and to overlook some of the previous rules. Only the FHA has maintained its requirements: it has not insured subprime mortgages, but its activity has been marginalized (thus the volume of insured loans grew by 30% in 2008).

Circumvention of the rules is one of the weaknesses resulting from regulation which is far too protective of fragile borrowers. That is one of the main hurdles to the development of the French Guarantee fund for low income ownership: it does give any guarantee to the mortgagors and the advantages it gives to the mortgagors are not decisive.

The other pitfall in imposing such a protective system is that it results in an excessively restrictive approach to credit, which corresponds a little to the French situation, which does not allow non-conforming households to have easy access to borrowing.

However, you cannot increase home ownership without mortgages and with that must go the acceptance of risk. A former Freddie Mac chief economist used to say: "if one wants the people to be able to buy homes, one must accept our ability to take them back"\(^6\). It is one thing to ensure that the mortgages provided are not too risky, but we must also ensure that the less well off customers can benefit.

To give access to credit to low income households, the community may bear a portion of risk through public insurance or guarantee schemes, such as FGAS in France, but it must also consider the consequences of failure of the projects on the borrowers themselves.

To the extent that some households present higher than average risks (low incomes, no room to manoeuvre) or a particular attributes (irregular income, poor health, old age, etc.), they must be supplied loans whose characteristics, commercial methods and servicing are adapted to their situation.

This is what is at stake, to reform the rules of the French guarantee fund for home ownership. Therefore, if the community fosters home ownership, its responsibility is engaged and it cannot ignore the conditions in which the operation is conducted.

The aim here is not to defend the "French model" and oppose it to the Anglo-Saxon one; the French model has its own defects, in particular it often prefers exclusion to pricing or risk, but it is the result of a choice.

The purpose of the examples above is to show that "regulation holds out"; furthermore, regulation does not impose costs. While governments are confronted with the limits of their policies to enforce affordability, that should encourage them to keep a close rein on the definitions governing the legal and regulatory environments relating to access to property.

Except to deprive itself of a large part of its means of action, those who have jurisdiction in matters of housing policy must retain the power to define the rules of the game of the credit market.

A halt to the integration of the European mortgage market?

Several of the examples above 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 rented to owned accommodation or from their parents’ house to one they owned themselves, but the key point is that we expect increased product availability to have the net effect of increasing the total demand for housing.”

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 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.

The age of the legislator

Once the crisis is over, governments will have to decide about their housing policy. Homeownership will very probably, for the same reasons that today, stay in favour in most countries.

The crisis will, however, have proved that a balanced distribution of housing between various tenures, ownership, social rented sector and privately owned rental sector is a stabilizing and reassuring factor, especially if the fluidity between tenures is not too expensive. Heavily indebted states will have to choose among public spending priorities and may focus more precisely on their

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1 The costs and benefits of integration of EU mortgage markets. Report for European Commission, By London Economics August 2005
targets, according to the areas and/or to the particular combination of circumstance and no doubt that they will fully exploit the power to set rules that have proved to be efficient during the crisis in some countries.

Bernard VORMS