

Understanding the challenge: changing housing systems

Housing Rights Watch – FEANTSA expert workshop
Madrid, 13 June 2014

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Outline of the presentation

The boom of housing finance before the crisis

- Falling interest rates and mortgage market innovations have fuelled the boom
- Household debt
- Funding of mortgages

Housing market dynamics

After the global financial and economic crisis

- Housing prices and construction
- Arrears and foreclosures

How affordable is housing?

Some lessons from the crisis

- Housing finance
- Other housing policy settings

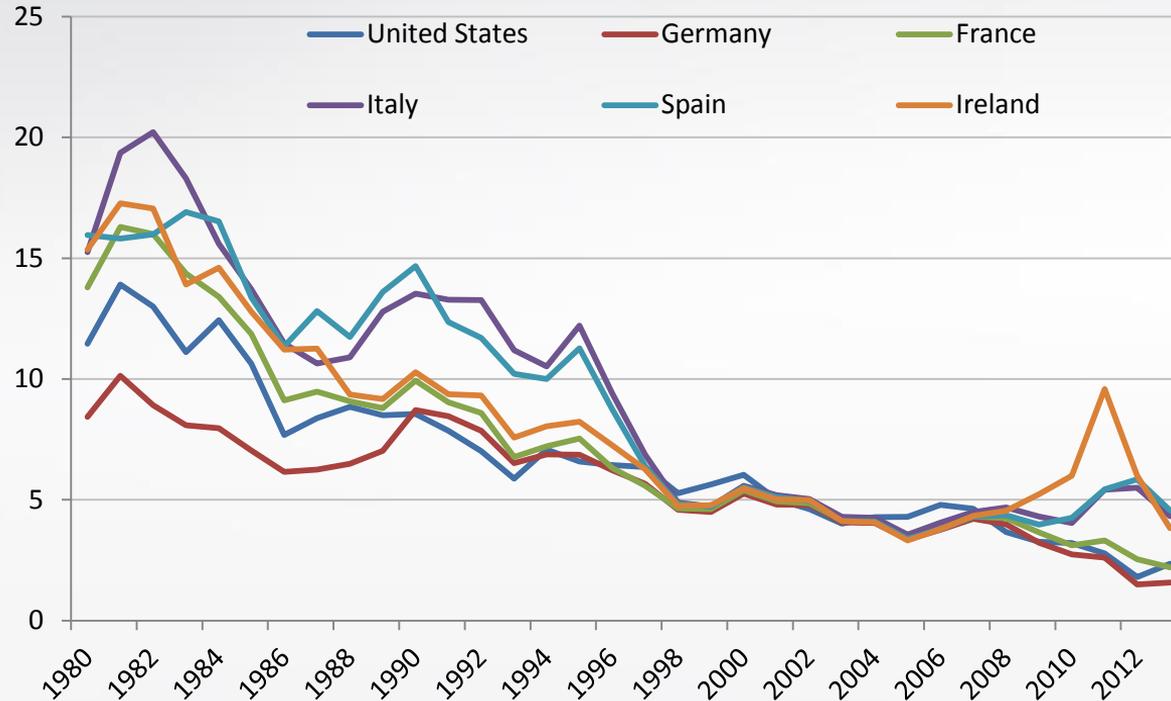
Conclusions

The boom of housing finance



Interest rates have declined spectacularly

Nominal long-term interest rates (10-year government bonds)



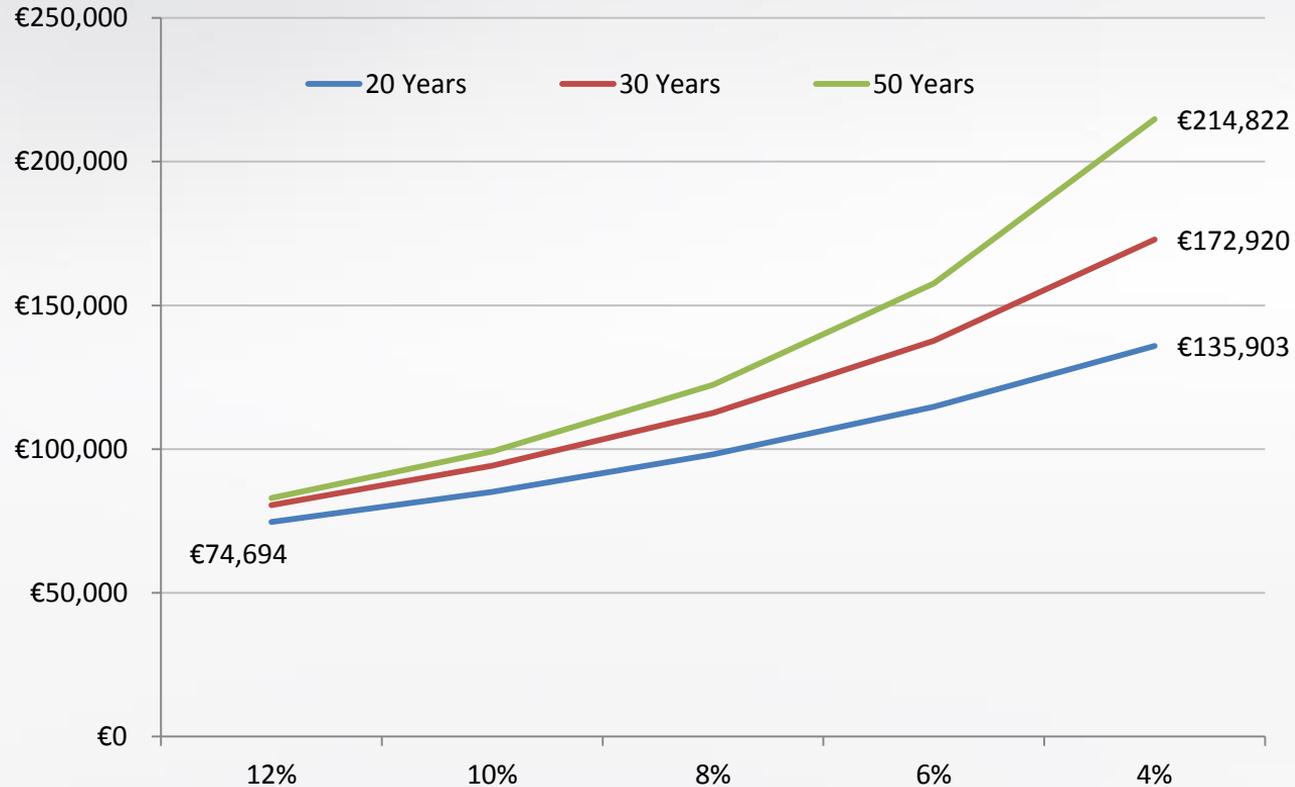
Source: OECD Economic Outlook database.

Mortgage market innovations have flourished during the boom

- Extension of loan terms
- Increased share of adjustable-rate mortgages
- Higher loan-to-value ratios
- Deferred amortisation loans (interest-only, flexible repayments...)
- Housing equity withdrawal (cash out refinancing, home equity loans)
- Subprime loans (and more generally weaker lending standards)
- Securitisation

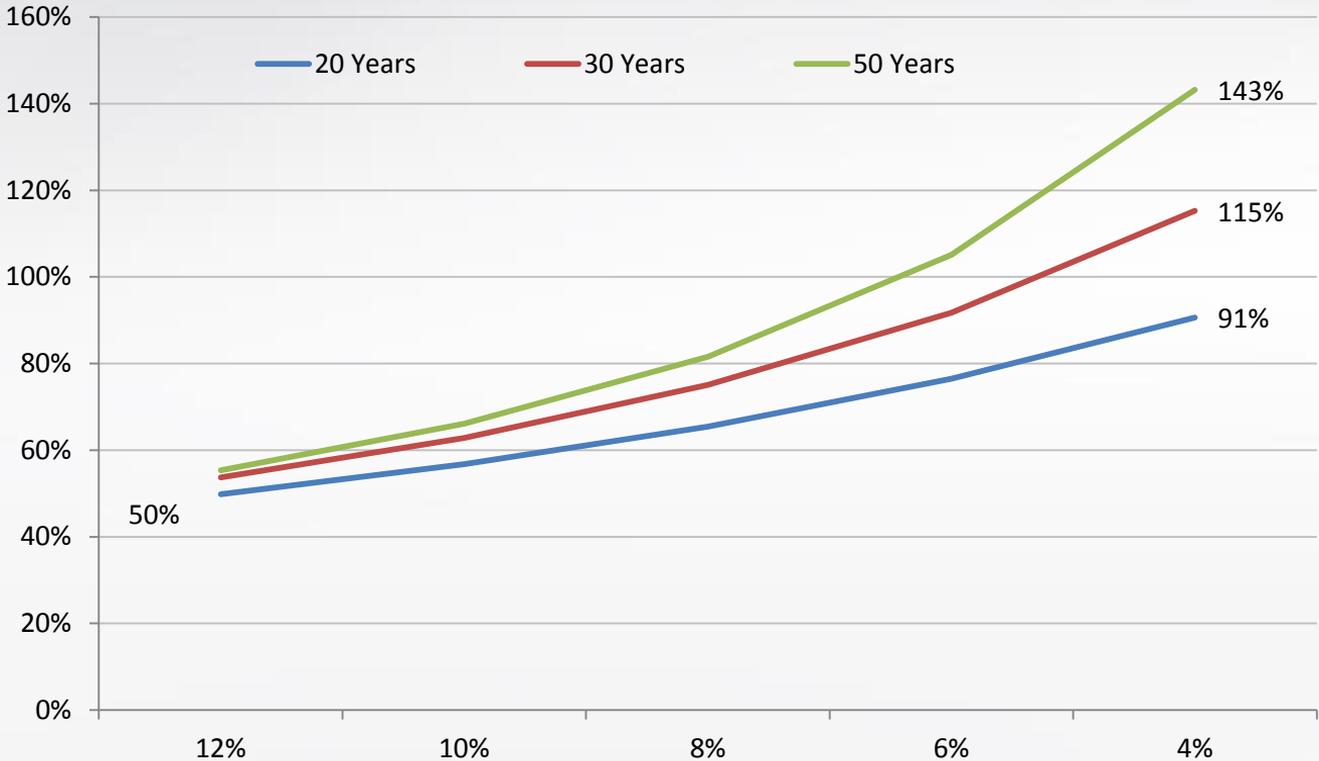
Low mortgage rates allow larger loans

Capital corresponding to a €10,000 annuity



High deposits increasingly exclude first-time buyers

Deposit (% of annual income); Annual income = €30,000; LTV=80%



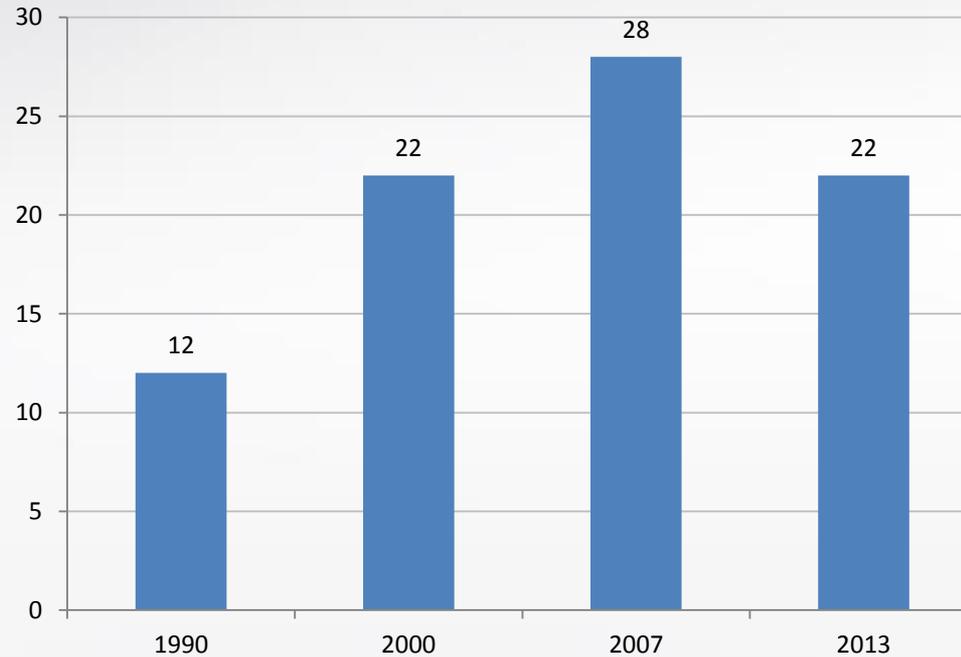
Share of all regulated mortgage sales represented by high-risk products in the United Kingdom in 2007

- 49% Non-income verified
- 32% Interest-only
- 28% Loan-to-income ratios of 3.5 or over
- 14% Loan-to-value ratios of 90% or over
- 4% Loans to individuals with impaired credit history

Source: FSA

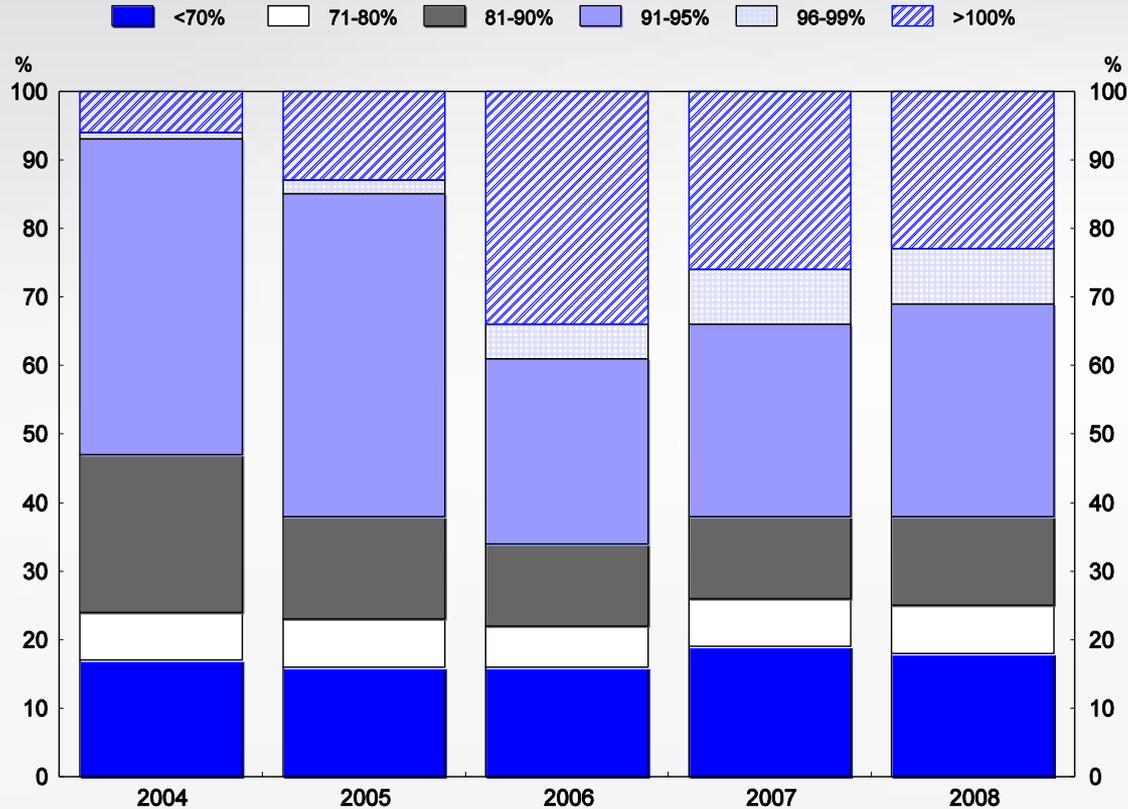
Average term of new mortgages in Spain

Years



Source: IMF and Bank of Spain.

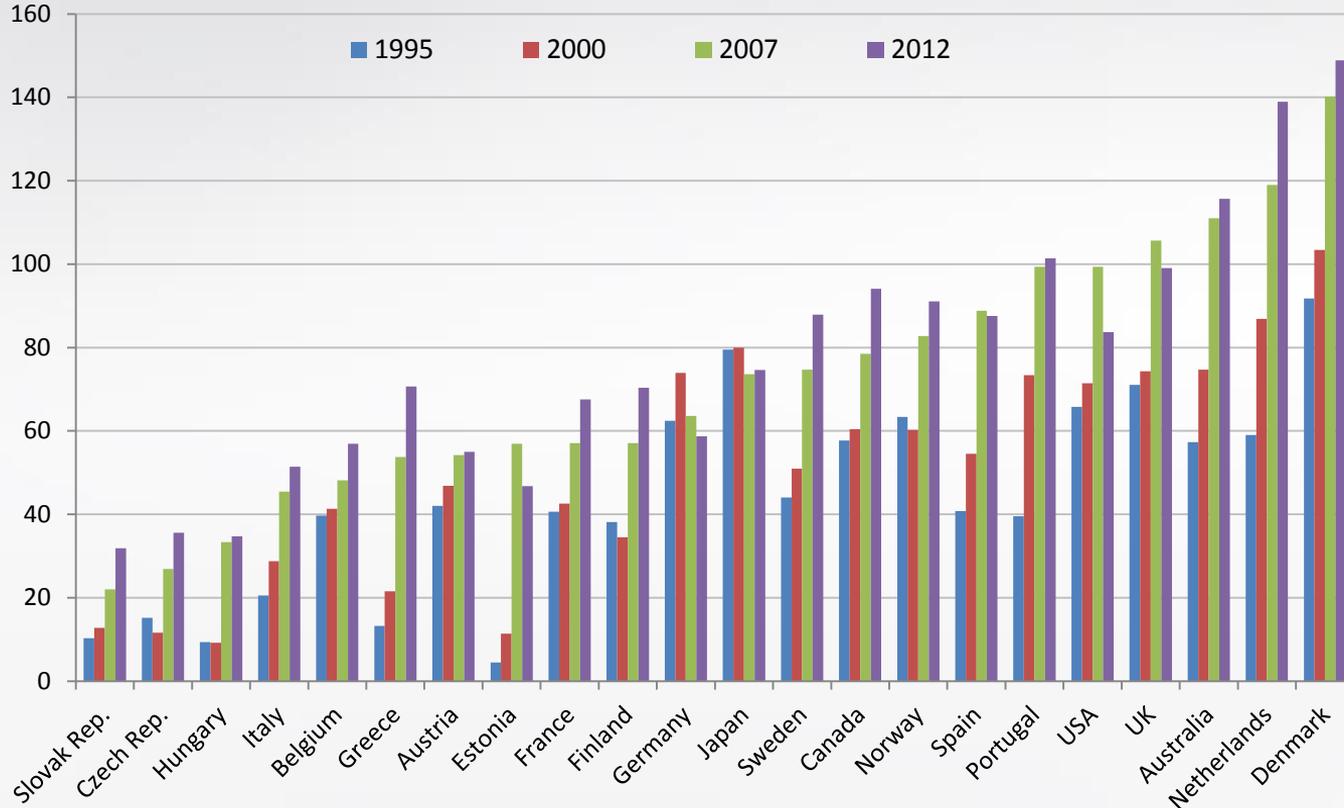
Loan-to-value ratios for housing of first time buyers in Ireland



Source: Department of environment, Heritage and Local Government.

Gross household debt

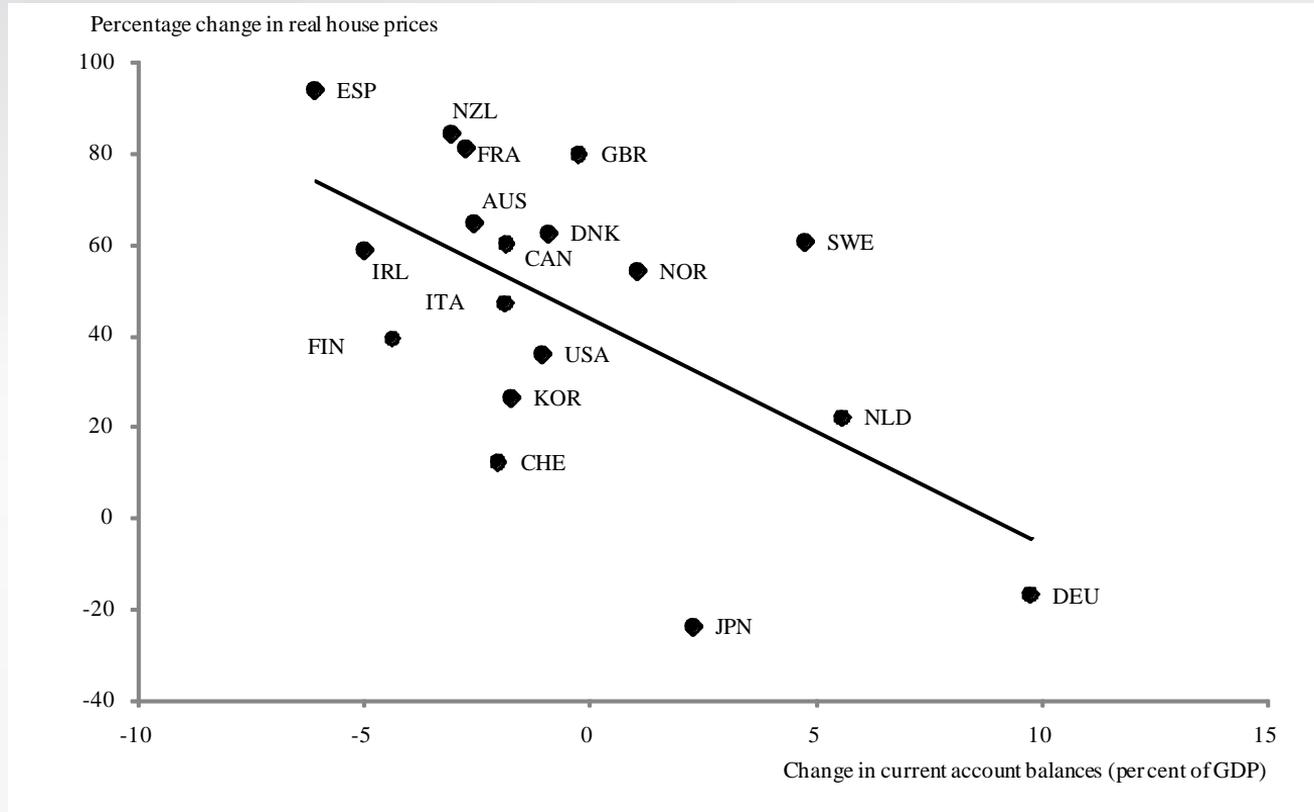
Per cent of GDP



Source: OECD Economic Outlook database.

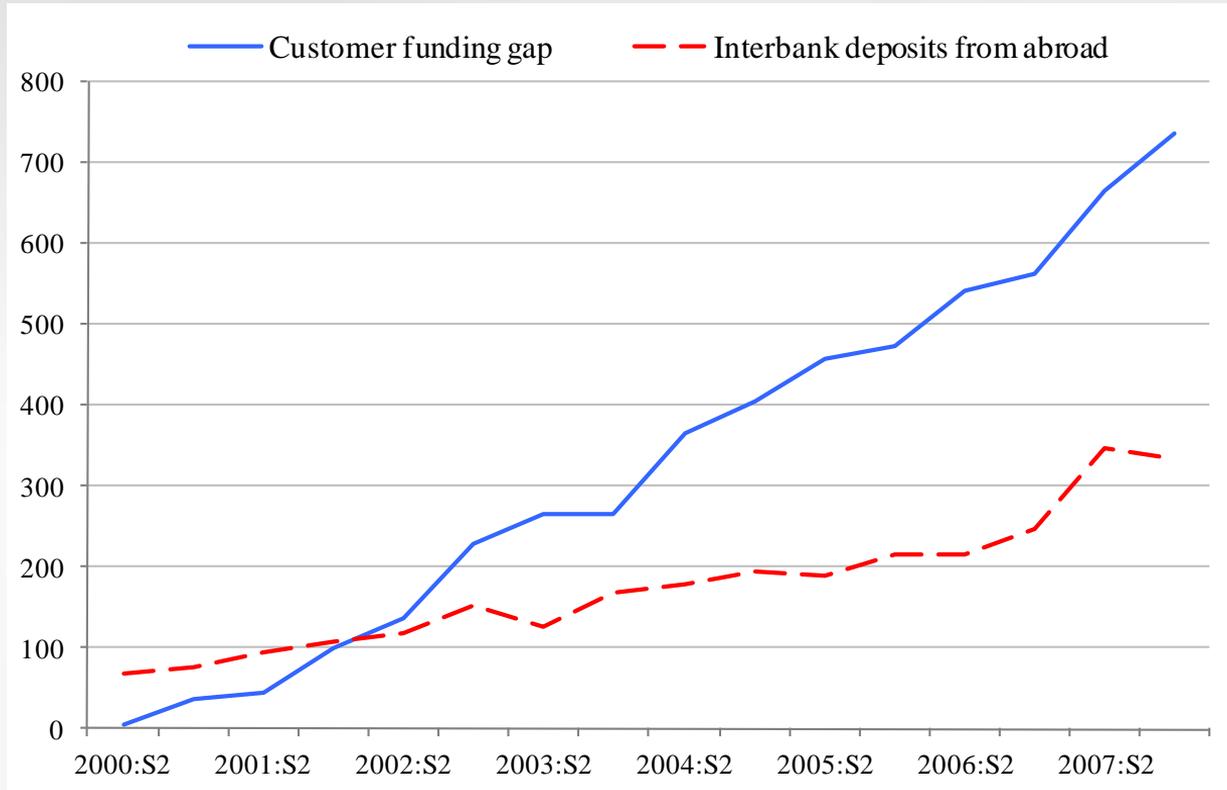
Change in real house prices and current account balances

2000-2007



Funding mortgages before the crisis: the UK example

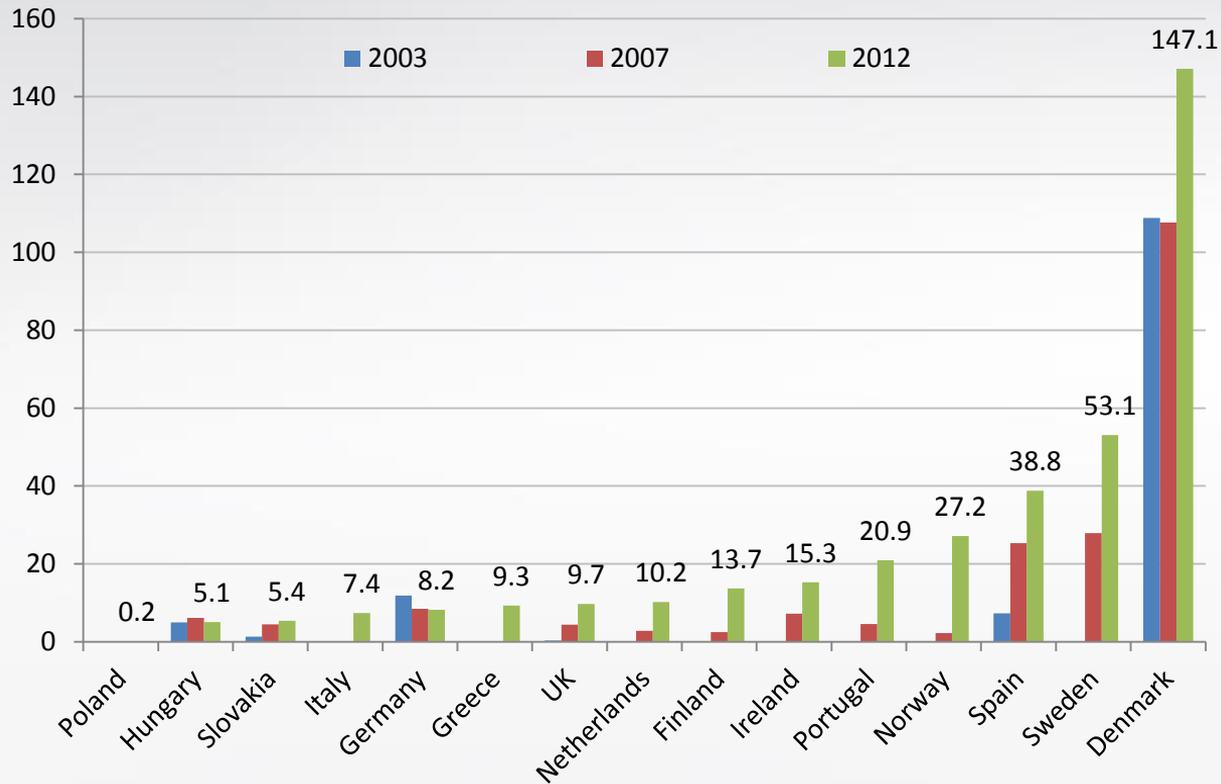
UK Banks funding gap (£ billions)



Source: Bank of England.

Covered bonds outstanding (backed by mortgages)

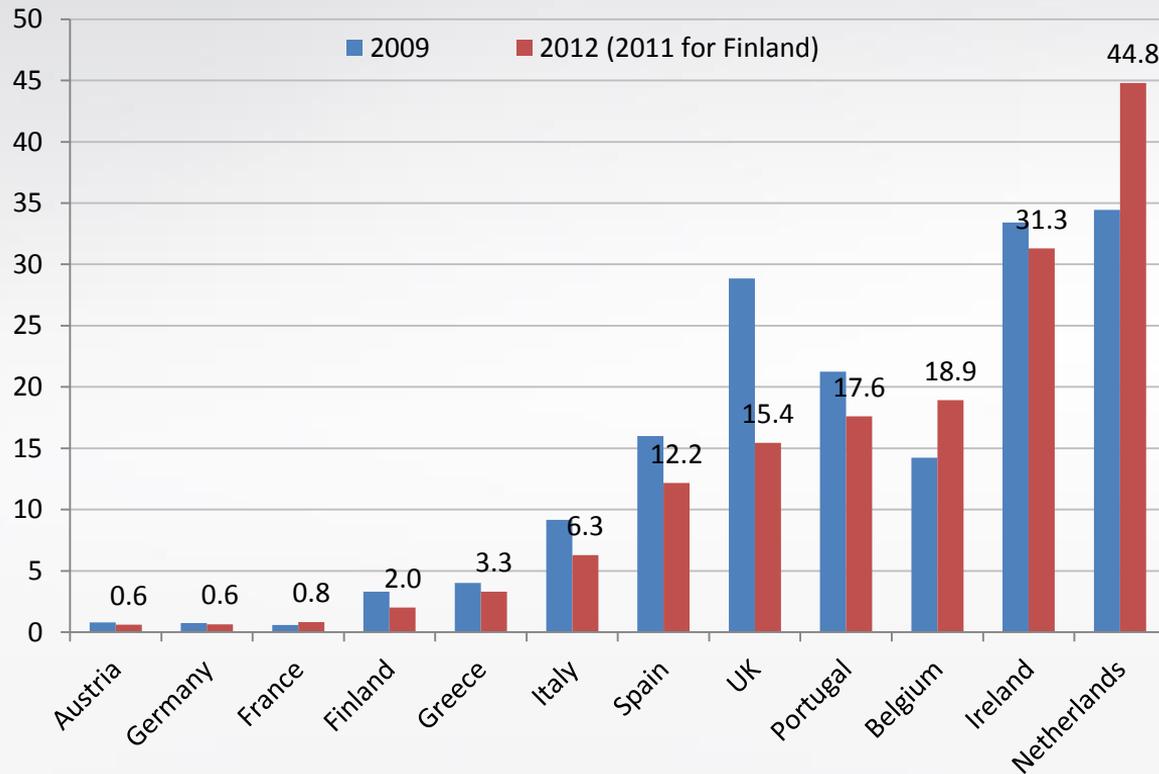
Per cent of GDP



Source: European Mortgage Federation.

Residential mortgage-backed securities outstanding

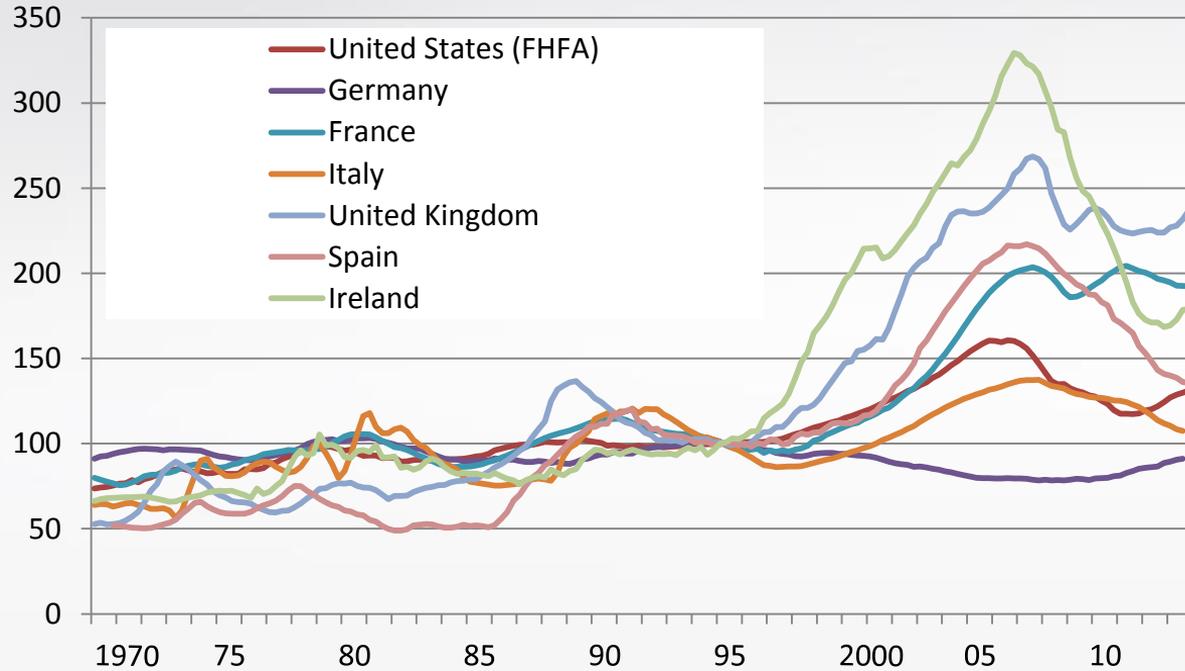
Per cent of GDP



Source: European Mortgage Federation.

An exceptional cycle

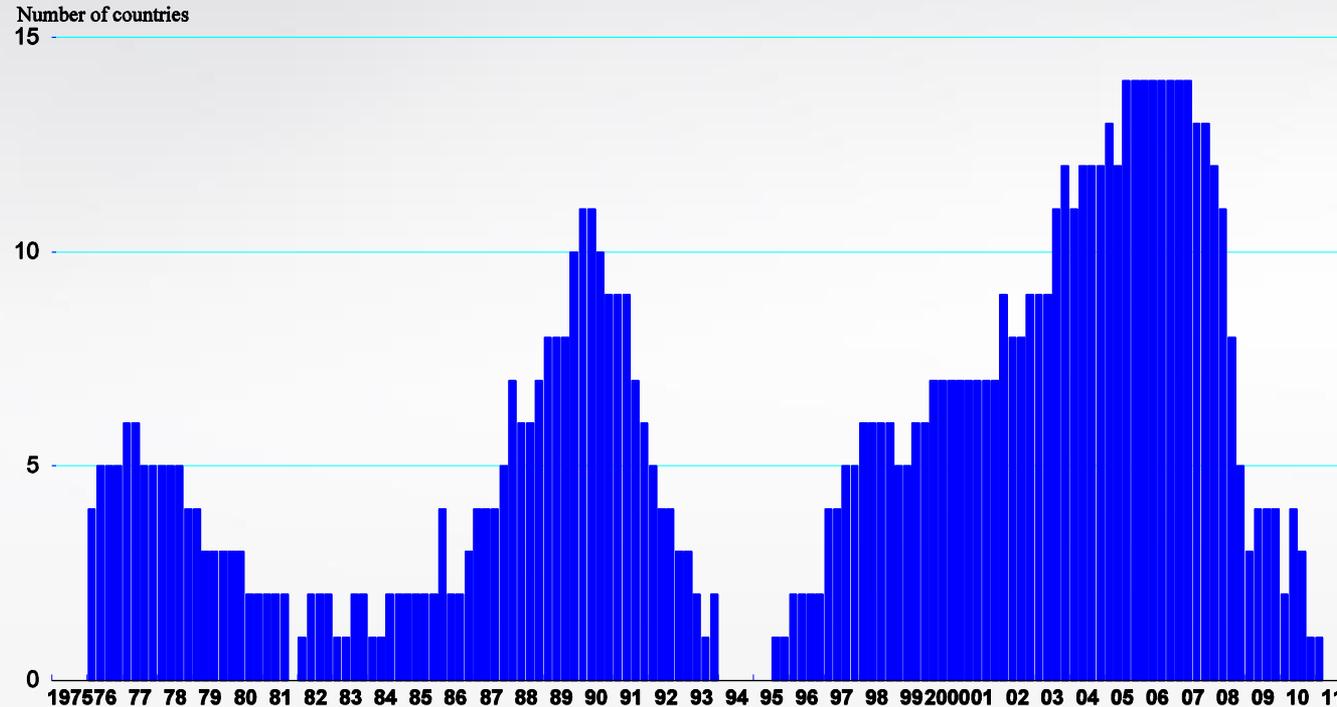
Real housing prices, 1995 = 100



Source: OECD and national sources.

Synchronisation across countries during the boom

Number of countries (out of 18) with an over 25% increase in real prices over the previous five years

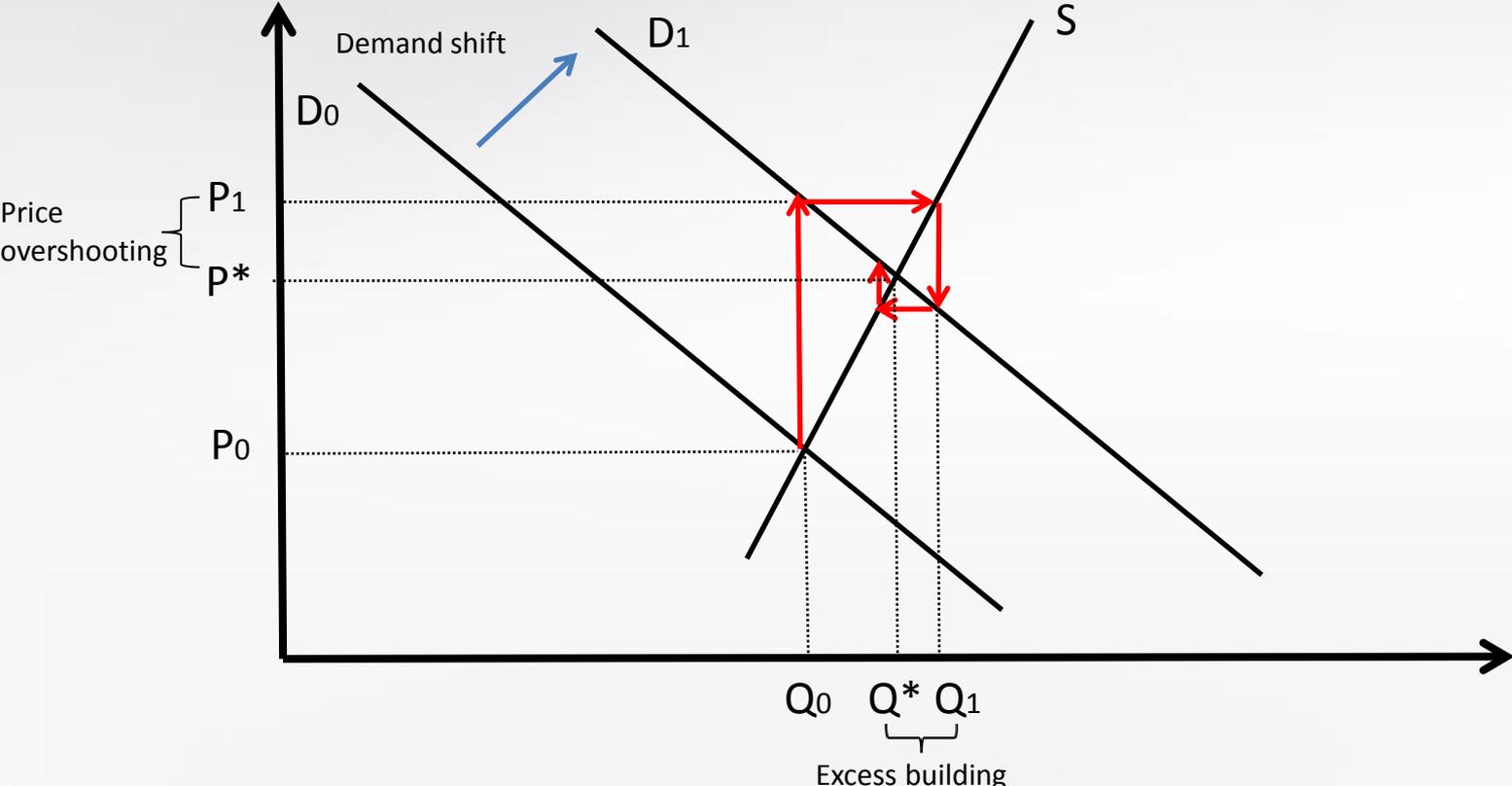


Source: OECD calculations.

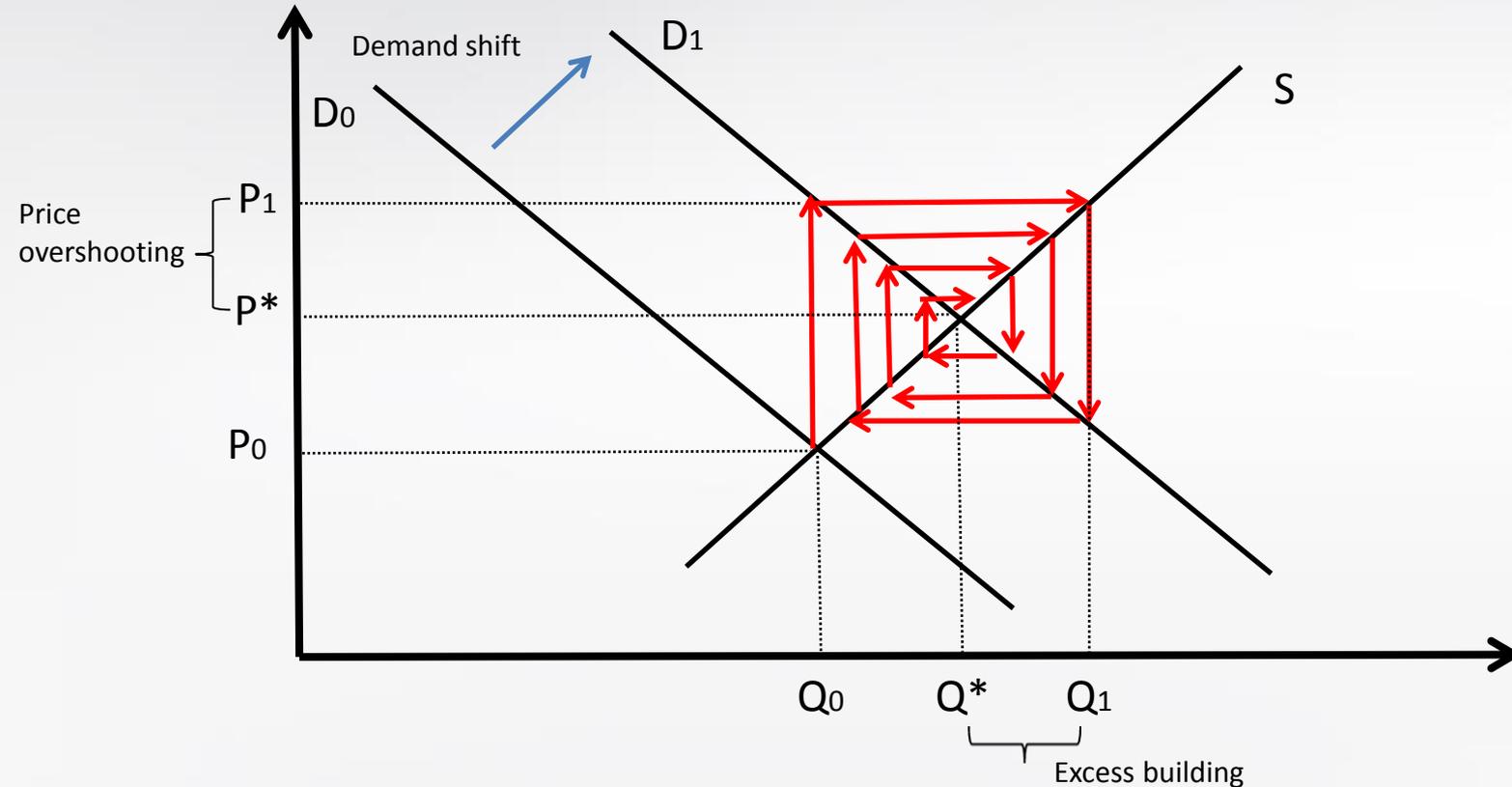
Housing price dynamics



Housing market dynamics: low supply elasticity



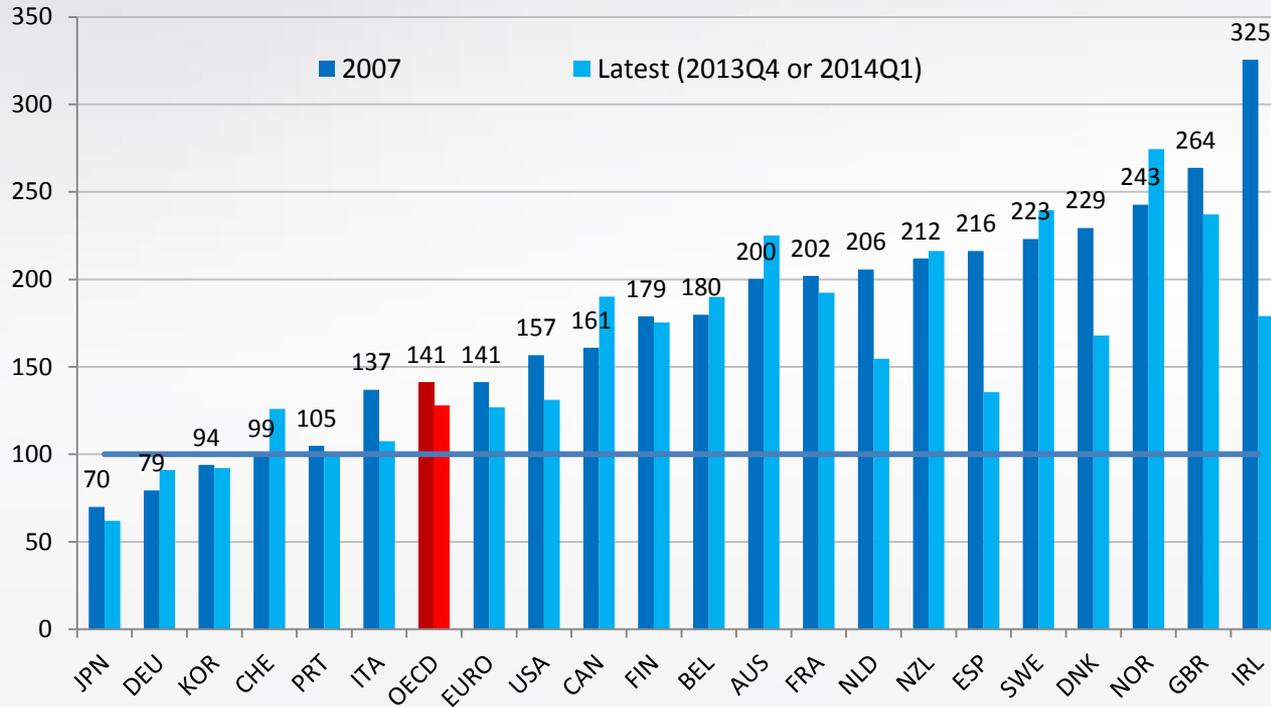
Housing market dynamics: high supply elasticity



After the global financial and economic crisis

Housing prices have fallen in many countries

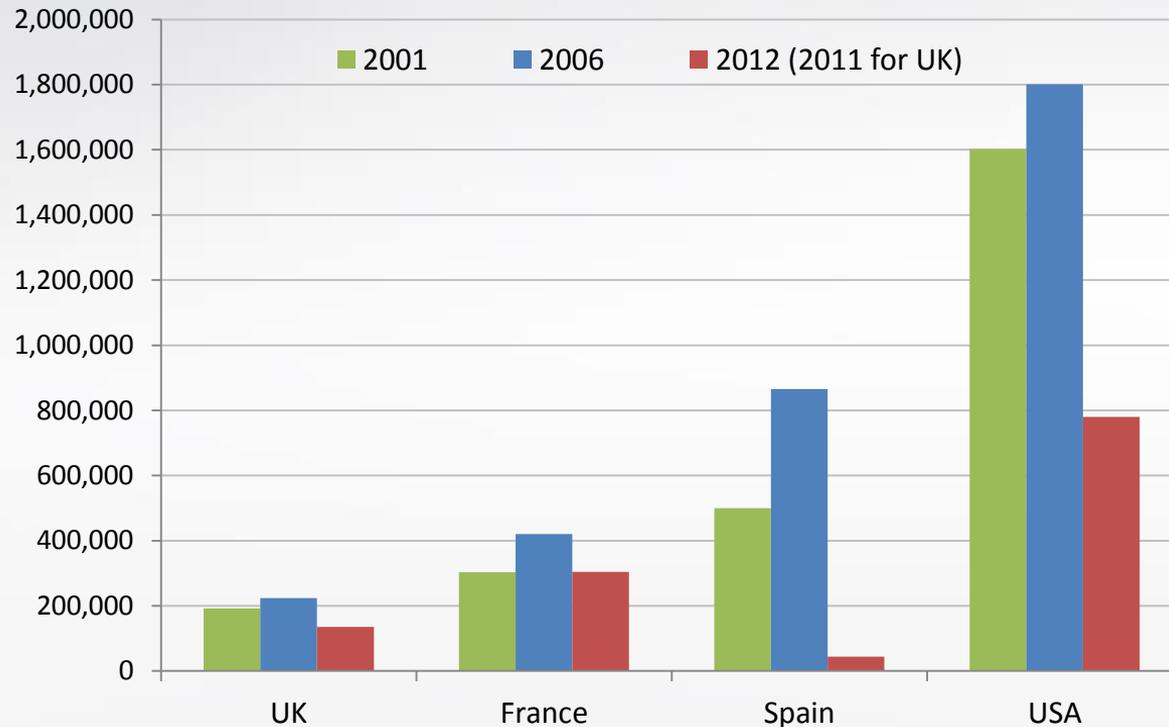
Real housing prices, 1995 = 100



Source: OECD and national sources.

Construction has collapsed in many countries

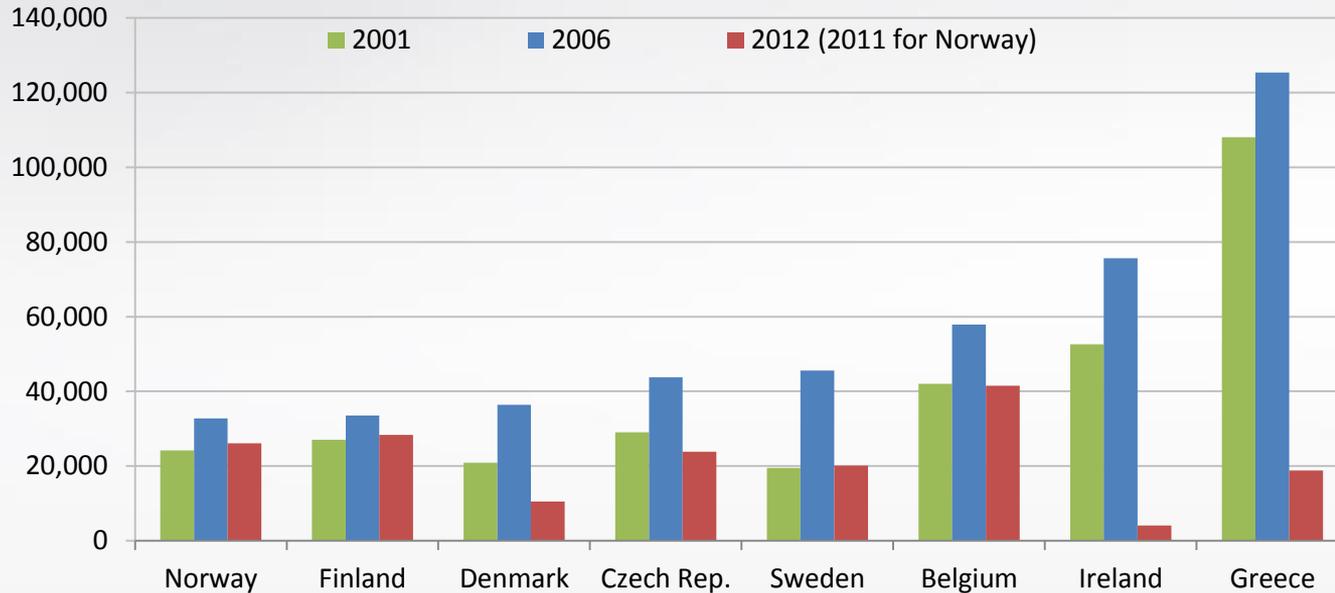
Housing starts



Source: European Mortgage Federation.

Construction has collapsed in many countries (cont.)

Housing starts

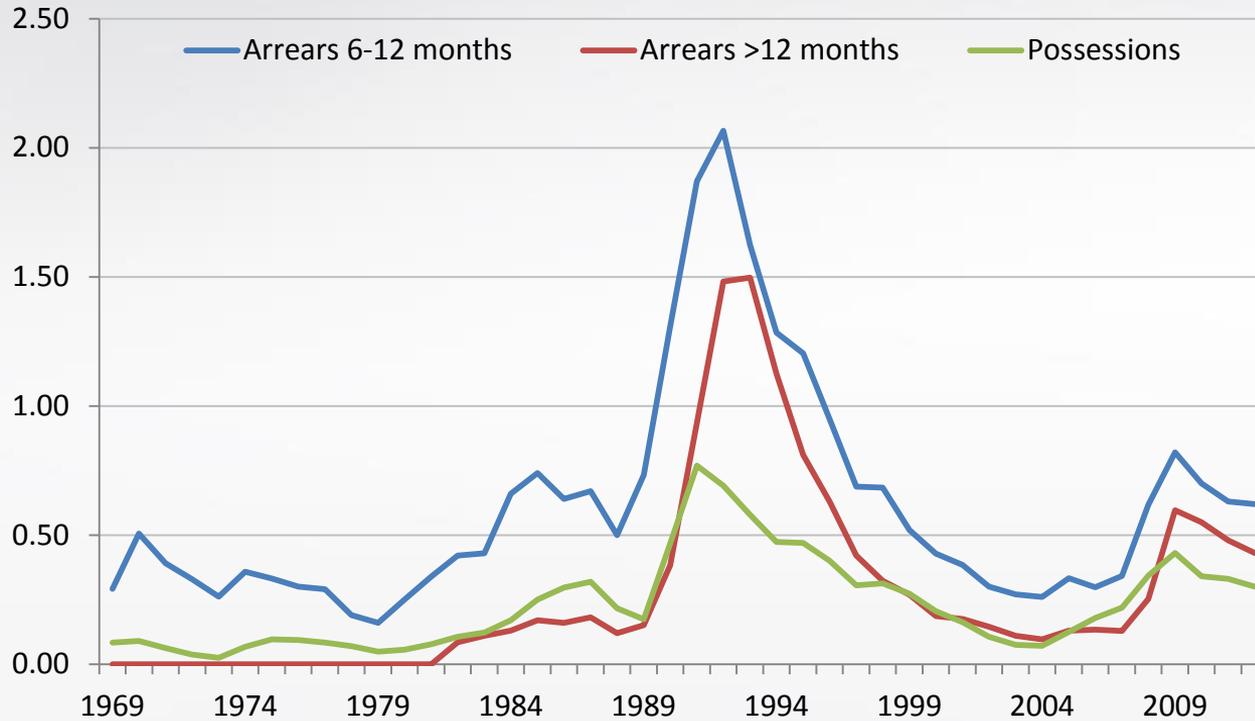


Note: Housing completions for Ireland in 2001.

Source: European Mortgage Federation.

Arrears and possessions in the United Kingdom

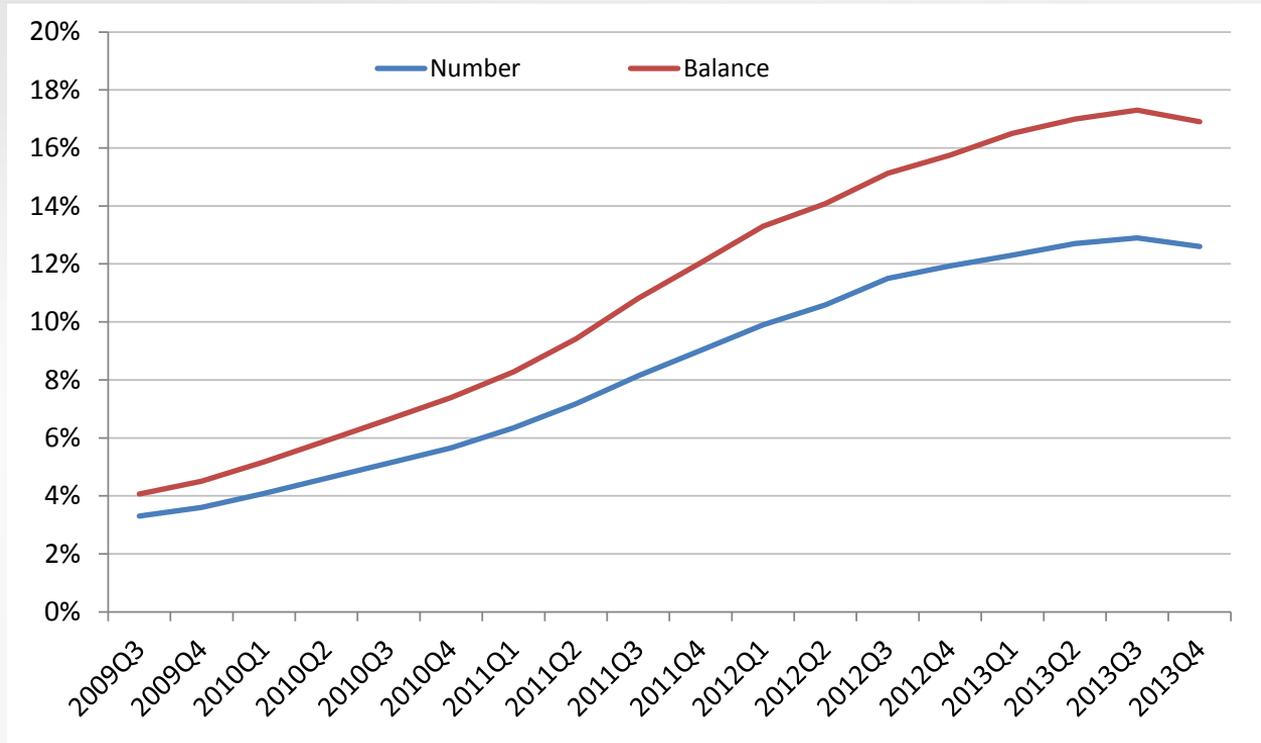
Per cent of outstanding mortgages



Source: Council of Mortgage Lenders.

Arrears in Ireland

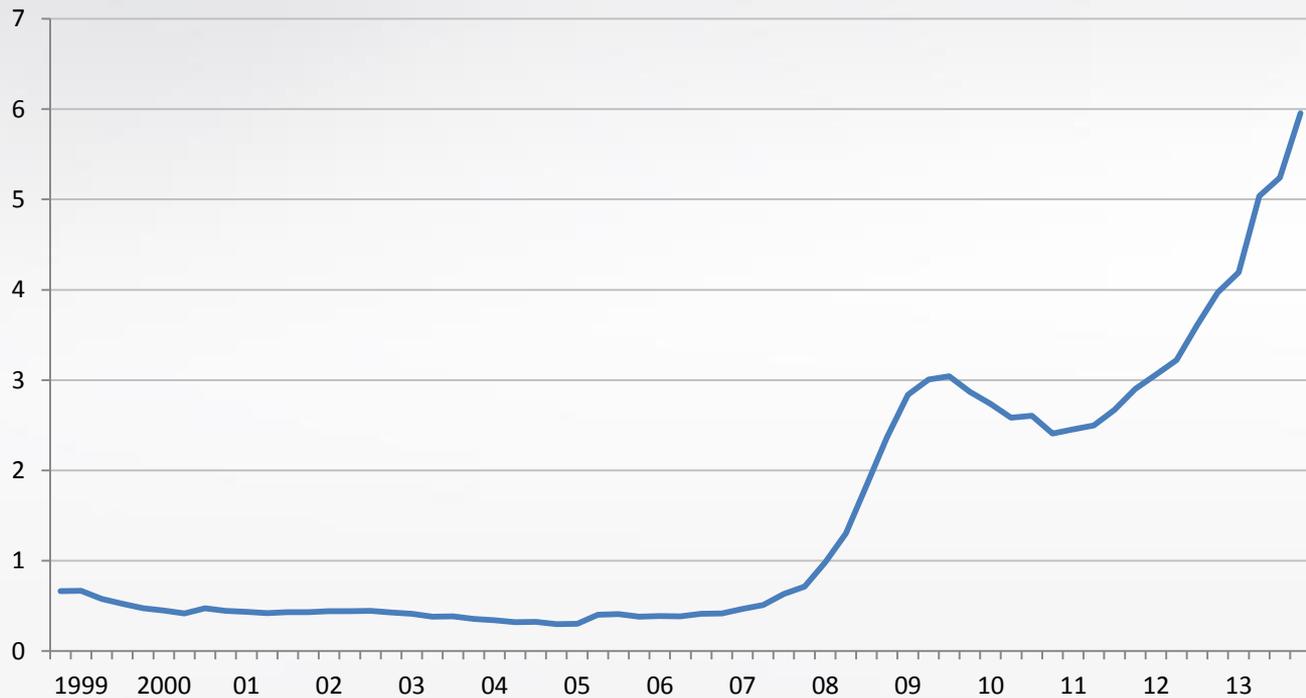
Percentage of loan accounts in arrears for more than 90 days



Source: Central Bank of Ireland.

Arrears in Spain

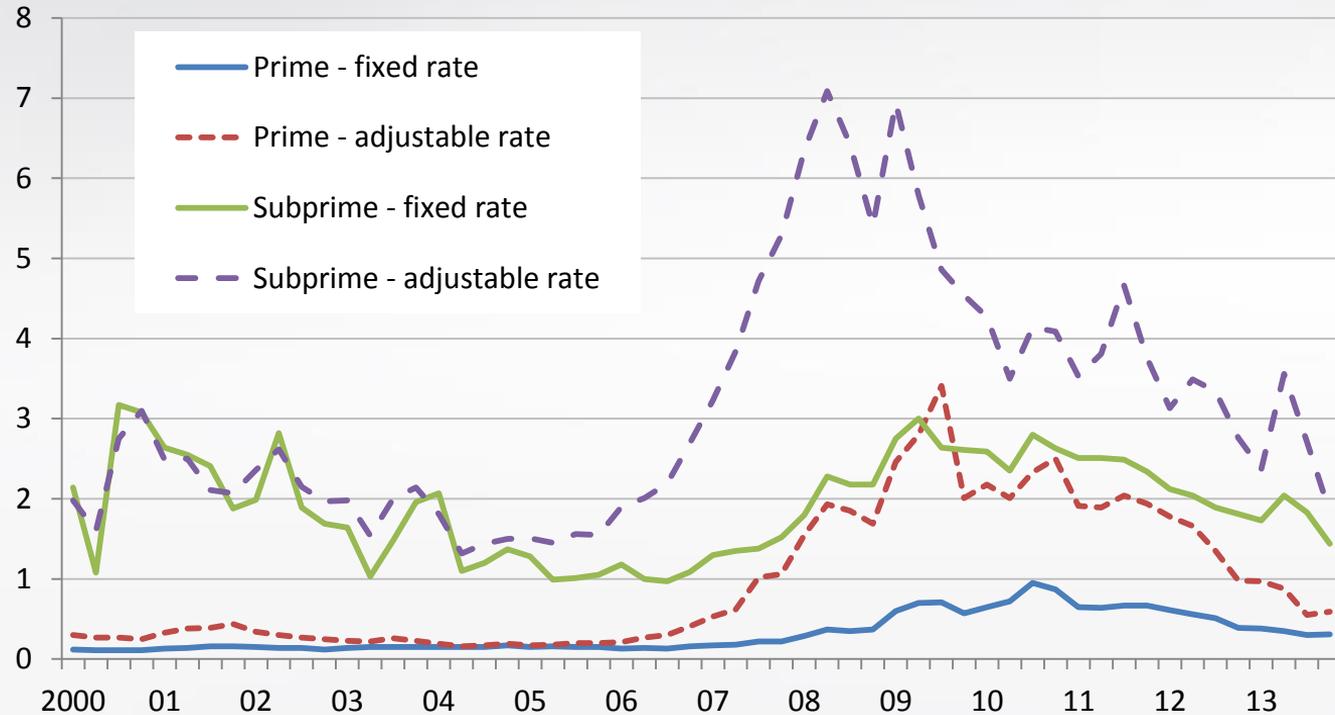
Percentage of non-performing loans for house purchase (>30 days in arrears)



Source: Bank of Spain.

Foreclosures in the US prime and subprime markets

Percentage of foreclosure started per quarter

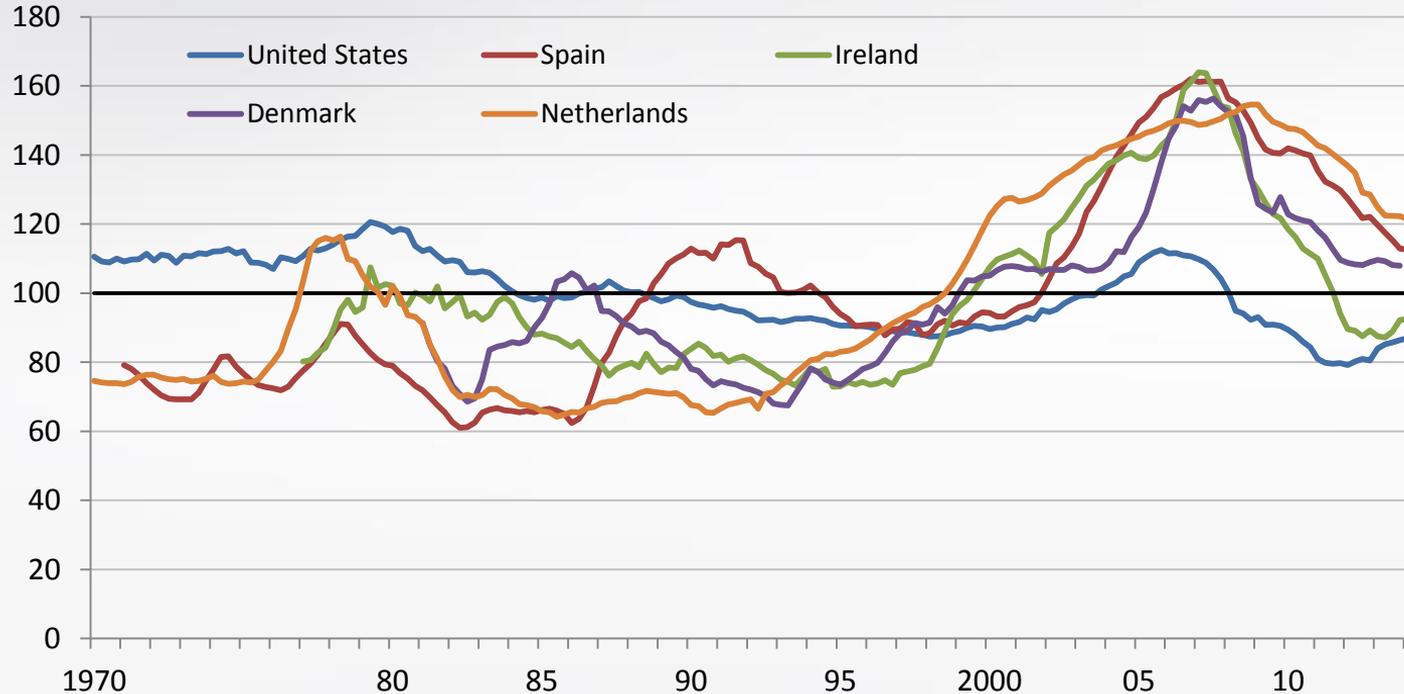


Source: Datastream.

How affordable is housing?

Prices are falling relative to income in some countries

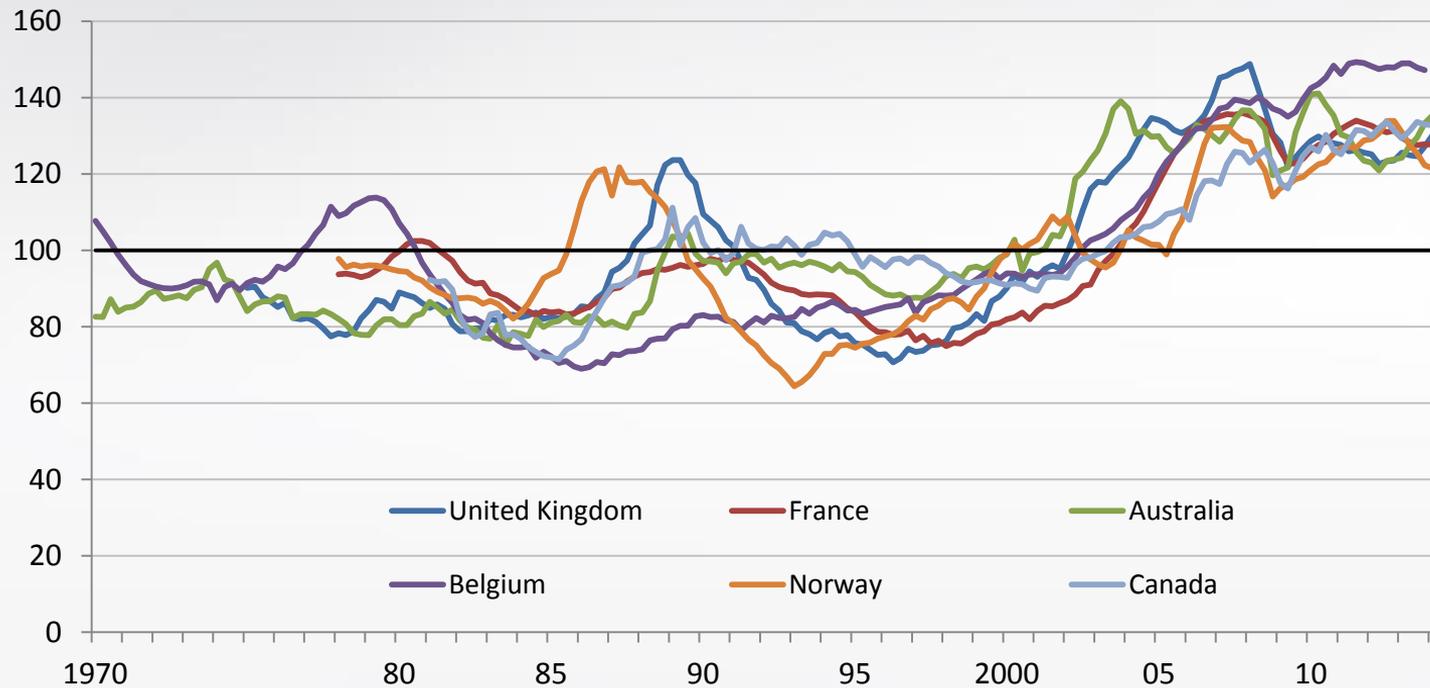
Price-to-income ratios, long-term average = 100



Source: OECD calculations.

Price-to-income ratios remain high in some countries

Price-to-income ratios, long-term average = 100



Source: OECD and national sources.

Housing cost overburden rate by tenure status, 2012

Percentage of the population living in a household where the total cost of housing exceeds 40% of equivalised disposable income

	Total population	Owner occupied, with mortgage or loan	Owner occupied, no outstanding mortgage or housing loan	Tenant — rent at market price	Tenant — rent at reduced price or free
EU-28 ⁽¹⁾	11.2	8.3	6.8	26.2	11.7
Euro area ⁽¹⁾	11.7	8.9	5.3	26.5	11.9
Belgium	11.0	3.6	3.9	37.4	15.1
Bulgaria	14.5	8.0	13.5	48.2	19.7
Czech Republic	10.0	4.0	6.8	28.2	20.9
Denmark ⁽²⁾	18.2	9.6	8.5	33.9	50.4
Germany	16.6	11.9	10.2	23.7	19.4
Estonia	7.9	8.4	6.4	27.9	9.4
Ireland
Greece	33.1	21.6	29.1	53.0	42.1
Spain	14.3	15.0	4.3	50.4	13.0
France	5.2	1.4	0.5	16.2	8.6
Croatia	6.8	13.6	5.9	33.1	9.3
Italy	7.9	5.6	2.3	33.5	9.7
Cyprus	3.3	4.0	0.2	19.9	1.1
Latvia	11.2	21.0	9.1	18.0	12.1
Lithuania	8.9	6.8	7.6	55.7	17.4
Luxembourg	4.9	1.1	0.6	17.1	1.7
Hungary	13.5	28.1	7.4	38.9	19.3
Malta	2.6	4.1	1.4	21.1	3.1
Netherlands	14.4	13.0	3.8	19.7	0.0
Austria	7.0	2.6	2.0	17.3	7.1
Poland	10.5	12.7	8.5	27.1	14.5
Portugal	8.3	7.2	2.8	35.9	5.6
Romania	16.5	42.1	15.7	76.3	21.4
Slovenia	5.2	8.7	2.8	26.6	6.1
Slovakia	8.4	24.8	5.7	15.1	8.7
Finland	4.5	2.5	2.6	11.8	9.1
Sweden ⁽²⁾	7.6	3.7	11.3	16.7	20.3
United Kingdom	7.4	5.1	1.7	23.1	7.4
Iceland	9.0	7.7	4.0	18.1	14.0
Norway	9.9	8.5	3.8	30.9	14.5
Switzerland	12.0	6.7	8.8	16.6	10.0

⁽¹⁾ Estimated data

⁽²⁾ Tenants — rent at reduced price or free: unreliable

Source: Eurostat.

A weak economy affects housing conditions in many countries

- High unemployment
- Slow or even negative real disposable income growth
- Rising income inequality and poverty
- Tight access to credit
- Cuts in government support (housing allowances, interest deductibility...)
- Collapse in construction, even where there are structural shortages
- Less resources for social housing
- Homelessness: rising in many countries; not only a housing problem

Some lessons from the crisis



Some lessons from the crisis for housing finance

Return to the “basics”

- Sound underwriting: ability to repay and documentation (income, assets...)
- Appropriate incentives and transparency
- High loan-to-value ratio loans: more capital or mortgage insurance; could be used as a macro-prudential instrument
- Non-amortising loans should be granted with great caution
- Adequate capital buffers for lenders and insurers

Areas requiring close monitoring

- Loans to developers and construction companies
- Loans for commercial property
- Lender’s funding model: maturity mismatch
- Shadow banking

Other policy settings have contributed to instability

Demand side:

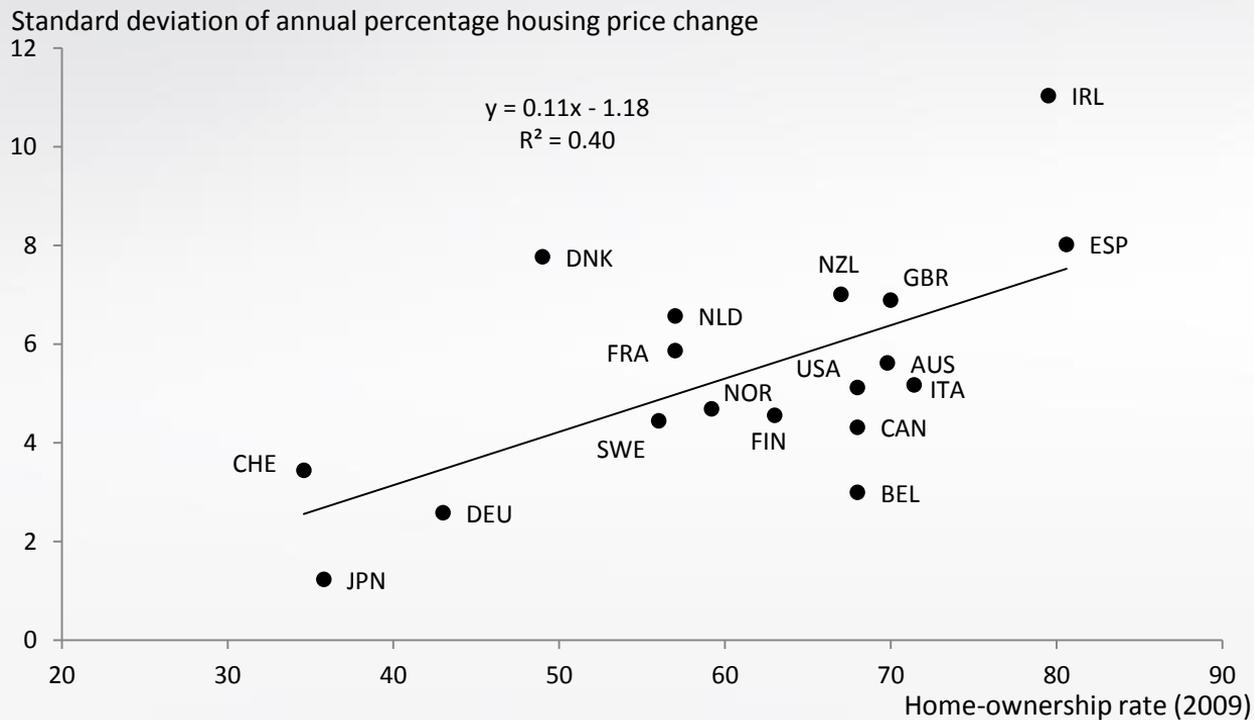
- Excessively easy monetary policy?
- Failures in financial regulation and supervision
- Tax systems often encourage home-ownership. Mortgage interest deductibility can be costly and tends to be regressive. If supply is rigid, capitalisation of tax advantage in housing prices

Supply side:

- Zoning and planning regulations are often excessively tight
- Infrastructure investment is sometimes insufficient
- Supply of new affordable/social housing is often low (partly because of costs and potential side-effects – segregation, weakening work incentives and mobility)
- Private rental market regulations (rent control, balance of protection of tenant and landlord rights) are hampering the development of the rental market in some countries

Housing price volatility and tenure structure

1995-2013



Source: OECD and national sources.

Conclusions

- Housing markets have become increasingly volatile over the past decades
- Low interest rates and mortgage market innovations have boosted demand; Risk management and financial supervision have been weak
- First-time buyers are increasingly excluded by deposit requirements
- Supply has evolved differently across countries, partly as a result of land-use regulations. Many construction booms ended in crashes, with severe consequences for the financial system (e.g. US, Spain, Ireland). In other countries, supply is insufficient relative to demographic evolutions (e.g. UK, Australia)
- Access to housing is increasingly problematic for some segments of the population in many countries, which has significant social and labour market consequences

Thank you!