Danish institution which operates internationally

NYKREDIT is a Danish mortgage credit institution which, in April this year, launched its first euro-bond issue to raise funds for the financing of properties outside Denmark. This is the first time a specialist property finance institution has raised money through a public issue to finance lending other than in its country of origin.

The issue was a six year 10⅛% euro sterling issue, and the funds raised are for Nykredit's lending in the UK.

The Danish mortgage system

Measured on equity, Nykredit is the largest of Denmark's three mortgage credit institutions. It has a market share of 40%, total assets of Dkr275,727 million (£23 billion) and reserves of Dkr15,422 million (£1.3 million), which is large compared even to international standards.

The typical Danish mortgage system dates back to 1795 when the first Danish mortgage credit institution was founded as a consequence of the need for the rebuilding of Copenhagen after the great fire, and since the late 19th century the mortgage credit institutions have had a predominant position within the area of financing of real property.

The central purpose of the institutions' activities is to grant loans based on the issuing of bonds. Loans are granted to finance new buildings, refurbishments, extensions and changes of ownership and both for residential property and commercial and industrial properties as well as agricultural.

The loans are granted on various terms, but the typical loan is a 20 years fixed interest rate loan, when talking about commercial loans and loans for refurbishments and change of ownership. For the construction of residential property the typical loan is a 30 years loan, also with fixed interest throughout the life of the loan.

A popular product of the Danish mortgage institutions, seen from the contractors' point of view, is the so-called advance mortgage loan. Against a bank guarantee the mortgage institution will pay out the long term loan before the construction of the project takes place. Although the constructor will still have to find his own construction financing, he has the great advantage of knowing his long term financing costs from the beginning of the project, and his bank, which is issuing the guarantee to the mortgage credit institution, knows that he has obtained the commitment to the long term financing, and will supply him with his construction finance.

Various other products are being offered and for the time being Nykredit offers loans with a fixed rate of interest for 20 or 30 years, bullet loans, index linked loans and loans with variable interest. The Danish Mortgage Act defines for which purposes different types of loans can be granted.

The Mortgage Act also sets up very strict rules for the loan limits of the mortgage institutions. The typical lending limits are 60% on commercial property, and 80% on residential property. Nykredit employs its own surveyors, and these are located all over the country. The loans are granted on the basis of their valuation of the properties.

Efficient system for borrowers

Seen from the point of view of the borrower, Nykredit and the other Danish mortgage institutions offer a unique system.

Nykredit is a wholesale organisation with only 59 offices in Denmark. The major part of the loan portfolio is generated through the banks and savings bank system and through real estate brokers. Customers can also contact Nykredit's offices directly.

The various financial advisers complete a loan application and as most of the brokers and all consultants are connected with Nykredit's computer system, Nykredit will receive the application on the same day, and the borrower receives his offer within three days.

Whenever the borrower wants the money, he tells Nykredit and Nykredit will sell the bonds corresponding to the amount he needs. He may also, if he wishes, obtain the bonds and sell them at a later point in time.

The system is very efficient, two reasons being that there is no deposit taking, which saves a lot of administration, and that the rule in Denmark is that the primary criterion when deciding the size of the loan is the value of the property, which saves a lot of work in that there is no assessment of the borrower's financial standing.

Another advantage for the borrower is a result of the above mentioned fact. When he wishes to sell his property, the new owner can take over the mortgage and thus save both time and money. This makes selling and buying of property much easier.

The funding of the mortgage loans

All lending is funded by the issuing of bonds. The variety of products demands a very sophisticated bond market, and because of the volume of the business, also a very liquid bond market. All bonds are sold on the

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Copenhagen Stock Exchange, which has a daily turnover of bonds of approx Dkr22 billion.

One of the typical features of the Danish mortgage institution is the very strict principle of balance. This means that there is a very tight connection between the amount of money being lent and the amount of bonds being sold.

What happens in fact is that every day the institution calculates the amount of granted mortgage loans and Nykredit may sell bonds for cash which is paid to the borrower, or alternatively bonds may be delivered to the borrower who may sell them to raise cash directly. The typical bond has a fixed coupon, and the market value of the specific bond determines how many bonds will have to be sold in order to finance each loan granted on that day.

This is one of the reasons why the Danish Mortgage Bonds are such a popular investment item. It means that although there is no direct link between the bonds sold and the mortgages received by Nykredit, there is always the security that there are corresponding assets.

Another interesting feature of the bonds is that in Denmark the borrowers are jointly and severally liable for the repayment of the bonds in that particular series. Mortgages with similar conditions are pooled together in one series, and bonds reflecting these conditions are sold. However, it has never been necessary for any of the institutions to call for such liability.

Nykredit abroad

Until 1985 the business of Nykredit and its two Danish competitors was purely domestic. This was changed when the Danish Mortgage Act was altered in order to allow the institutions to internationalise their business. Now the institutions are allowed to grant loans in all countries which are members of the OECD. For the time being this means that Nykredit is offering its mortgage loans in West Germany, England and Wales.

Nykredit is trying to export all the good features of the Danish system, and hopes to be able to offer the same variety of products on the foreign markets as it is doing on the domestic market. Nykredit has found that there is a great demand for the fixed rate products, and this is why these are the ones that are being marketed initially.

Because of the nature of the international capital market, it is, however, not possible to raise funds at a fixed rate of interest for 20 or 30 years at attractive prices or at all, and therefore the product offered, in Germany as well as in the UK, is an interest adjustment loan. This is a loan where interest is fixed for periods of approximately five years. Recently a product with variable interest rates has also been introduced.

Loan limits are the same as in Denmark, ie 60% of value on commercial property and 80% of value on residential property. In order to have the properties properly assessed Nykredit collaborates with local surveyors both in Germany and in England.

In principle loans are granted for the same purposes as in Denmark, but at present Nykredit will confine itself to the financing of commercial, residential or mixed schemes worth between £1 million and £10 million. At the moment Nykredit and the other mortgage credit institutions are not allowed to finance changes of owership abroad.

Although not as efficient as in Denmark, the procedure when applying for a loan with Nykredit in England or in Germany is a very simple one, and there is a minimum of time involved in obtaining a loan offer. Nykredit is also trying to transfer the idea from Denmark that a property can be sold with the existing loans.

Funding of international activities

Until now, all Nykredit's lending abroad has been dealt with out of Copenhagen, ie, as cross border financing. The Danish Mortgage Act does not allow the mortgage institutions to take any currency risks in their international business, and therefore the funding of the foreign lending cannot be done by selling bonds on the Danish Bond Market.

Until mid-1988 the institutions were allowed to refinance their lending by bank credit lines, but this permission has expired and the institutions have now found new and better ways of funding. This explains why Nykredit has been active in the international capital market in the last six months.

In December 1987 Nykredit established a $100,000,000 ECP-programme combined with a $50,000,000 syndicated back-stop facility. The funds raised through these facilities are swapped into the needed currencies. In April 1988 Nykredit launched a £50,000,000 10⅛ Euro bond issue due 1994. The bonds are listed on the Luxembourg Stock Exchange. Funds raised this way are directly applicable for the UK lending.

Nykredit is a major issuer of bonds in the Danish market, and its internationalisation will follow that line through a future build up of Nykredit's presence in the international capital market. With the present diversification between domestic and euro markets in Europe, Nykredit's strategy also goes towards an establishment in the local markets, primarily in the UK and West Germany.

Basically Nykredit has been involved in securitisation of mortgages for more than 125 years. The popularity of securitised mortgage lending in the international capital market in the 1980s will give Nykredit a chance to play a major role in the continued expansion of that particular market segment.

At the same time an increased flexibility in the funding of mortgage lending will offer new possibilities to develop new mortgage loan products and enhance customer services, thus creating opportunities to develop an attractive asset side of the business too. ■