# Housing finance in Italy

By Bruno Mazzola

**THIS article begins by describing the trends and structure of the housing market in Italy, and then analyses in detail the present methods of financing investment in housing, in particular the role of the various financial institutions. The article then concentrates on the types of loans granted, and bonds issued by the mortgage credit institutions which are the major housing finance lenders.**

ITALY has a high proportion of owner occupation. The proportion of the population living in rented housing has fallen from 60% in 1951 to 40% now. Many owner-occupied houses have been built recently, and this is one reason why there is relatively low population mobility.

During the 1970s in particular, housing was the form of investment favoured by Italian families as a method of safeguarding against the future, and of passing on wealth to children. Until 1982 two-thirds of the average family's savings were invested in housing.

Only in the last few years has the evolution of the financial markets resulted in more profitable investment alternatives being offered. The transition from a situation of negative real interest rates to positive real rates has contributed significantly to the slowing down of investment in housing.

Between 1975 and 1985 the proportion of the wealth of Italian households invested in housing declined from 58.4% to 54.4%, and by contrast investment in government bonds, shares and unit trusts increased. The number of new houses built fell from 500,000 a year in the 1970s to 415,000 in 1982 and 270,000 in 1987.

1982 marked the beginning of a new cycle. Investment in property now largely reflects choice rather than necessity. Accommodation is changed only if better and more comfortable accommodation is available. This is confirmed by examining the movements in house prices, and the number of property sales.

An unusual feature of the Italian market is the large number of second homes, in line with the nature of the country. At the 1982 census, of all owner-occupied homes 20% were second homes, and in the following few years about 25% of houses built were second homes.

The market in rented accommodation is a controlled one. From 1978 the law on "equo canone" (fair rent) set specific regulations for the determination of rents and rules governing the relationship between owners and tenants. This law, even if it does not penalise owners with respect to rent, sets considerable obstacles to the free availability of rented property, as it is largely designed to protect the tenant rather than the owner.

*Methods of financing investment in housing*

The proportion of housing investment financed by financial intermediaries in Italy is relatively small compared with other countries. This is due partly to the well known tendency of Italians to save, and secondly to their preference for investing in housing. Official statistics do not exist, but my own bank's estimates are that financial intermediaries accounted for only 23% of housing investment in 1987. Of the remainder, 3% was financed by public funds, 3% by technical reserves of insurance companies, and a huge 71% by private savings.

The government, in addition to financing some of the housing for less wealthy families with its own funds, also subsidises loans granted by mortgage credit institutions for building or buying a house on a means tested basis. In total about 6-7% of property investment in Italy is financed by direct or indirect intervention of the government. However, in addition, borrowers are entitled to deduct interest on their mortgage loans up to a maximum of £1,700 (£3,000 in some particular cases) from their taxable income.

An important role in housing finance is also played by insurance companies and pension funds, which invest a proportion of their reserves in property, either directly or through buying mortgage bonds issued by mortgage credit institutions. Currently, about 11% of the mortgage bonds outstanding are held in the portfolios of insurance companies and pension funds in compliance with regulations.

The major intermediaries in the housing finance market are the banks and the mortgage credit institutions. The 1936 banking law, which is still in force, provides that the Italian banking system is based on specialisation. Banks specialise in short term credit, and mortgage credit institutions in medium and long term credit.

This rigid distinction has now changed considerably, and the banks are increasingly dealing with medium and long term financing, especially to house buyers. The banks are particularly interested in housing finance because it enables them to acquire new customers with whom they can establish a lasting relationship, and produce additional business.

It seems that in 1987 the banks financed about 8% of housing investments, but this figure could be an underestimate because it is impossible to separate in the official statistics the proportion of personal loans granted by banks to people which are also used for house purchase or improvement.

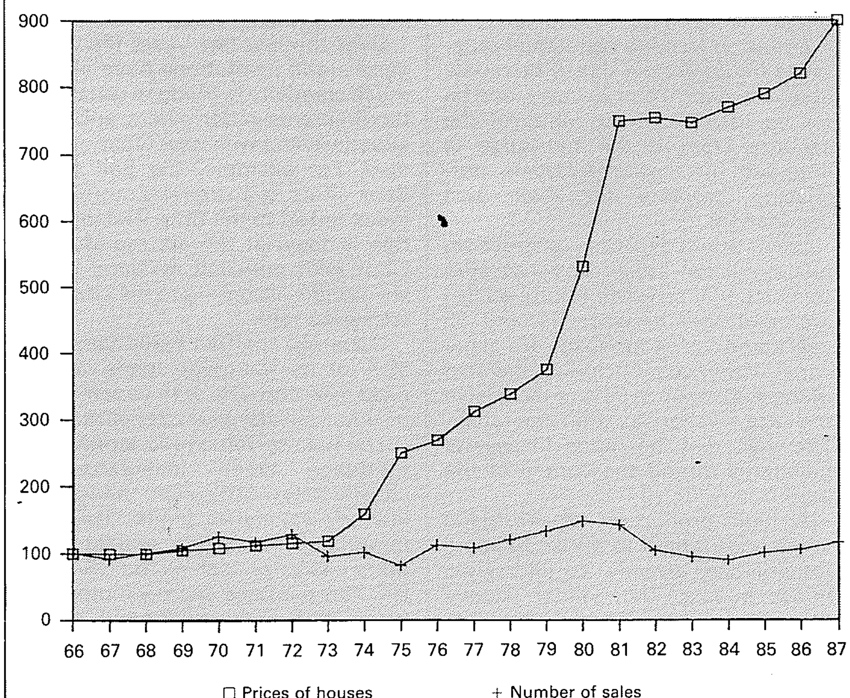
It must be stressed that the banks finance housing investment mainly with short term deposits. Their loans carry a variable rate of interest linked to the variation in the official discount rate, and are generally quite small.

Over the last few years these loans have decreased because of the introduction of tight bank credit limits, although these have now been abolished. However, it may be that the development of this type of financing will be hindered by limits recently set by the Bank of Italy to the growth of medium and long term bank loans.

These limits were designed to ensure a maturity of bank assets in line with their liabilities. If the banks wish to play a more important role in housing finance in the future they will probably have to securitise part of their housing loans.

**ITALIAN PROPERTY MARKET**

(1966 = 100)




*The mortgage credit institutions (istituti di credito fondiario)*

The mortgage credit institutions are specialised in financing housing construction, which includes large property development and reconstruction projects, and they are funded by bond issues. The system of housing credit is based on a 1976 law which amended a previous law of 1905. The reform of 1976 marked the passage from the system of mortgage credit with a German structure, where the mortgage bonds (cartelle fondiarie) were issued in proportion to the loans granted with exactly the same repayment terms, to a system with the classical structure of the Crédit Foncier. The removal of the rigid linking gives greater flexibility to the institutions.

The new law has maintained the number of credit institutions in operation, and provides for new authorisations to institutions having a paid up capital of at least £200,000. There are at present 21 mortgage credit institutions of which 12 are sections of banks, and nine are separate legal entities, although they are owned by banks and savings banks.

These institutions can grant loans secured by a first mortgage charge with differing characteristics according to whether they finance the purchase or the construction of a

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**DISTRIBUTION OF HOUSEHOLD INVESTMENTS IN ITALY**

| | *1975* | *1980* | *1985* |
|---|---|---|---|
| **Real estate** | **72.1** | **73.9** | **65.4** |
| Houses | 58.4 | 59.7 | 54.4 |
| Agricultural land | 7.1 | 6.8 | 3.6 |
| Durable goods | 6.6 | 7.3 | 7.4 |
| **Financial assets** | **30.4** | **28.1** | **36.7** |
| Money activity | 18.9 | 16.9 | 16.8 |
| Government bonds | 1.0 | 3.7 | 9.9 |
| Shares | 2.0 | 2.2 | 4.7 |
| Life insurances and pension funds | 6.0 | 4.3 | 4.3 |
| Other assets | 2.5 | 0.9 | 1.1 |
| **Financial liabilities** | 2.6 | 2.0 | 2.1 |
| Long term liabilities | 2.0 | 1.3 | 1.4 |
| Other liabilities | 0.6 | 0.6 | 0.7 |
| **Net total assets** | **100** | **100** | **100** |

*Source:* Banca D'Italia

← 17

building, as well as advances for periods of more than 18 months guaranteed by a mortgage charge under the same conditions as loans.

Loans on existing residential properties (mutui fondiari) may be repayable between 10 and 25 years, and be for up to 50% of the value of the security (75% if the mortgage is intended for first-time buyers purchasing property for their own occupation).

Loans granted for the construction, reconstruction, repair or conversion of residential property (mutui edilizi) are repayable between 10 and 35 years, and can be for up to 75% of the construction cost (including the cost of the site), or up to 90% of the cost in the case of reconstruction and repair. The loan may be made in several payments during the course of the work.

A high proportion of mortgage loans are granted to house builders rather than directly to individual house buyers. The builder usually obtains, on the basis of progressive payments, a loan which is then split into parts equivalent to the value of single properties, each of which is then assumed by the respective buyers.

*Characteristics of mortgage loans*

The most widely used mortgage loan instruments are:

(a) The classical mortgage with a fixed interest rate and constant instalments comprising both principal and interest.

(b) The mortgage with a variable interest rate, and principal repaid by constant or, alternatively, increasing instalments.

Over the last few years the mortgage credit institutions have shown much creativity in trying to satisfy the requirements of borrowers, and have experimented with new types of product. For example, the San Paolo Bank offers its customers mortgages index-linked to the ECU. The interest rate is fixed at the six month ECU Libor with principal revalued every six months according to the Lira/ECU exchange rate.

Currently, the San Paolo Bank has 55% of its mortgage loans with a fixed rate, and 45% with variable rate or other special characteristics.

The loan-to-value ratio among the mortgage credit institutions is usually below 50%, even though the law allows higher limits. This differentiates the Italian market from other countries such as the USA and UK. This cautious approach provides for a high security margin which partly reflects the fact that it is not possible to link the granting of mortgages to the income of borrowers.

The law itself does not fix specific limits for the instalment/income or loan/income ratios. In practice, however, for mortgages directly given to individual home buyers the ratio of monthly payment to income is usually kept within a multiple of three.

However, such a valuation is not made when a mortgage is granted to the builder, and then transferred to home buyers. The same applies when a borrower sells a mortgaged property. Unlike in other countries, when a property is sold the mortgage is not usually paid off, but, rather, is transferred to the buyer of the new building.

One peculiarity of the Italian system is that interest and principal are paid on a six monthly basis.

The most common loan maturity is 15 years. Almost all mortgages in Italy are repayable by instalments consisting of increasing amounts of principal, which means that the actual average life is about nine years. Early repayment of mortgages is not common, partly because mortgages are assumable.

A borrower who wishes to repay a loan early must pay a compensation fixed by contract for the loss suffered by the lender in placing the bonds issued to finance the loan, as well as an additional penalty up to a maximum of 1%.

It is difficult to assess the incidence of early repayments, but clearly this is linked in the case of fixed interest rates to the evolution of interest rates. In a period of decreasing interest rates, for example, many people pay off their loans.

Mortgage delinquency has increased in recent years because of the weight that mortgages granted in the past — with exceptionally high interest rates — have borne in relation to the income of some households. Usually in Italy the length of time after which delinquency is triggered is 12-18 months, and the time to foreclose is rather long, usually up to four years.

However, for the period of delayed payments interest on arrears continues to accrue at the current market rate plus 4%, which means that institutions have not been unduly penalised by cash flow delays. The amount of actual final losses is, in any event, almost insignificant.

The spread over the cost of funding at which mortgages are granted is usually variable according to the destination of the funds, varying from 1.5 to 1.75% for first-time buyers to 2% for second-time buyers, and 2.1% for non-residential buildings. However,

**THE MORTGAGE BONDS MARKET IN ITALY**
**(end of 1987)**

| *Investors* | *(billion lira)* | % |
|---|---|---|
| Banks | 33,332 | 63.6 |
| Insurance companies | 4,688 | 8.9 |
| Pension funds | 1,132 | 2.2 |
| Households | 9,929 | 19.0 |
| Others | 3,305 | 6.3 |
| Bonds outstanding | 52,384 | 100.0 |

the mortgage credit institutions have improved their gross income by skilful management of their financial position. In 1987 the overall margin on the liabilities was higher than 3%, of which about half was ear-marked as reserves for possible loan losses.

Mortgage loans are largely originated through branches of banks to which mortgage credit institutions are linked. Banks also make co-operation agreements with other financial institutions, and use their own sales forces for financial products where they have these.

The insurance companies play only a minor role in the mortgage market, partly because endowment mortgages are not as well developed as in other countries. The only insurance required at present when a mortgage is granted is the building insurance.

*Mortgage bonds*

Mortgage credit institutions have at their disposal two funding instruments, mortgage bonds and certificates of deposit. Legislation allows the issuing of bonds up to a maximum of 30 times the capital funds of the institutions (a special ministerial decree can increase this multiple to 50).

Certificates of deposit have a maturity of between 18 and 60 months, and must be contained within the same limits, but their total volume cannot be higher than the amount of mortgage advances and instalment payments made towards the construction loans.

There are several types of bond on the market, for example, fixed rate bonds with a final maturity of 10-15 years, bonds with a fixed rate revisable every five years within a period of 15 years, and floating rate bonds with an interest rate reset every six months and a final maturity of 10 to 15 years. The interest rates are linked to financial or monetary variables such as the prime rate, the lira interbank rate, the current yield on treasury bills or bonds issued by special credit institutions.

The bonds are usually redeemable in accordance with a redemption scheme fixed in advance. Within each series the bonds to be redeemed are drawn by lot, with appropriate publicity being given. The redemption scheme of single issues can be revised, according to early repayment of loans made by borrowers.

On the primary market the issuing conditions are set by the bank of Italy, whose responsibility it is to control the supply of bonds, and ensure an orderly development of the financial market as a whole. At present the Bank of Italy authorises the issue of fixed rate bonds with a semi-annual coupon of 6.05% (annual yield 12.50%) and floating rate bonds with a coupon at 5.75% (annual yield 11.83%).

The coupons of mortgage bonds are payable net of a withholding tax of 12.50%. These yields are more or less in line with those of the Italian Government bonds, even though these are for shorter terms, have the bullet redemption system, and better security.

At the end of 1987 the Italian mortgage bond market totalled 52,000 billion lira (about £23 billion). The banks held about 64% of bonds, insurance companies and pension funds 11%, private investors 19%, and others 6%. Some of the bonds are listed on the Stock Exchange.

*Conclusion*

The Italian housing finance system has elements of strength and tradition which could allow it to compete with the systems of other countries, although obviously with necessary adjustments such as credit scoring procedures, and reviewing the procedure of automatic transfer of mortgages. The internationalisation of the Italian mortgage system is favoured, and the experience of other countries and new financial instruments is being closely studied. ■

**FINANCING OF INVESTMENTS IN HOUSING SOURCES OF FUNDS Year 1986**

| | |
|---|---|
| Public funds | 4 |
| Insurance companies reserves | 2 |
| Mortgage loans from banks | 9 |
| Mortgage loans from mortgage credit institutions | 11 |
| (of which subsidised) | (3) |
| Financing from other credit institutions | 1 |
| | 27 |
| Private savings | 73 |
| Total of housing investments (about 21 billion pounds) | 100 |

**PROPERTIES COMPLETED**

| *Year* | *Number of properties* |
|---|---|
| 1982 | 415,000 |
| 1983 | 405,000 |
| 1984 | 420,000 |
| 1985 | 320,000 |
| 1986* | 300,000 |
| 1987* | 270,000 |

*Estimates
*Source:* CRESME

**MAIN FEATURES OF THE ITALIAN MORTGAGE LOANS GRANTED BY MORTGAGE CREDIT INSTITUTIONS**

| | |
|---|---|
| Fixed rate | 55% |
| Floating rate (+ other characteristics) | 45% |
| Loan/value | 50% |
| Assumable | yes |
| Interest and principal payments | semi-annually |
| Term (most usual) | 15 years |
| Average life | 9 years |
| Yearly prepayments (% of outstanding) | 8% |
| Delinquency triggered | 12-18 months past due |
| Delinquency (% of outstanding) | 8% |
| Time to foreclose | up to 4 years |
| Actual losses (% of outstanding) | 0.05% |

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