

# Mortgage Finance in Denmark

by Torben Gjede

## OVERVIEW

The first Danish mortgage bank was set up in 1797 as a direct consequence of the need to finance the rebuilding of Copenhagen after a great fire in 1795. Since the mid-19th century, the mortgage banks have taken up a predominant position in the financing of real property in Denmark.

The Danish mortgage market is based on effective and low-cost arrangement of credit of which the following features are characteristic:

1. The loans are granted against security in the real property of the borrower.
2. The loans are fixed-interest, long-term loans.
3. The loans are granted within certain limits laid down in the Mortgage Credit Act.
4. The effective interest is fixed by the market in a transparent manner.
5. The loans are funded entirely through issuance of bonds.
6. The bond investors have full knowledge of the security of the bonds, which is based on the mortgage on the real property, the

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legal framework and the solidity of the mortgage bank.

7. Through nearly 200 years all bonds have been repaid.

Through the long-standing tradition as financial market players specializing in the granting of long-term loans against mortgages on real property, the mortgage banks have achieved a central position in the Danish economy. The significant dual role of the mortgage bonds—as an effective funding instrument on the one hand, and a secure investment on the other—has given the bonds

a central position in the Danish capital market, and in the longer term also in a wider international perspective.

There are presently nine mortgage banks in Denmark. The key figures for the lending activities of these banks are presented in Table 1.

## THE DANISH FINANCIAL MARKET

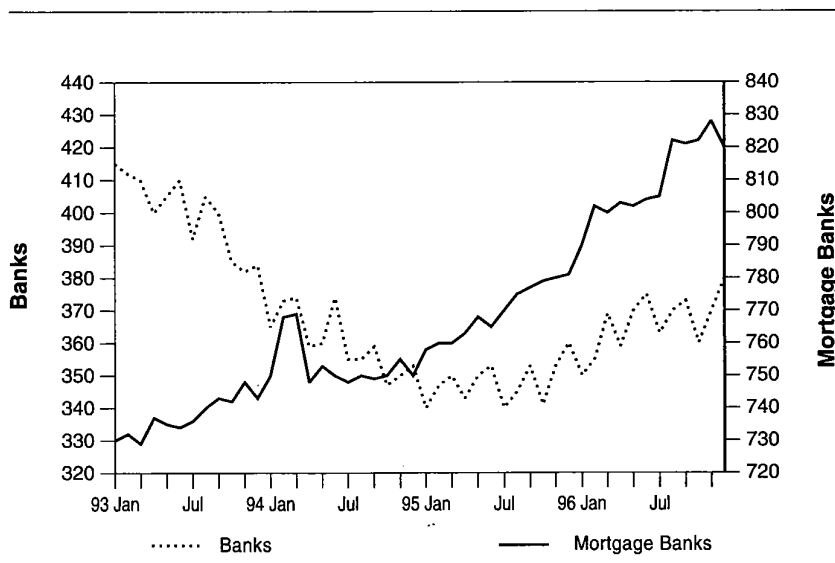
In Denmark, the financing of real property and other long-term real investments mainly takes place via the mortgage banks. In recent years the share of the market by the mortgage banks

**Table 1.** Key Figures for the Lending Activities of Danish Mortgage Banks

	1994	1995	1996
Gross new loans, total DKK bn	258.5	138.9	214.5
<i>Percentage share of:</i>			
Rental homes	14.0	12.5	11.2
Owner-occupied homes	54.6	60.3	53.7
Farms etc	13.5	10.2	11.2
Manual and manufacturing industries	4.3	5.2	8.0
Offices and shops	12.3	10.7	14.2
Other properties	1.4	1.1	1.7
Percent, total	100.0	100.0	100.0
Volume of bonds in circulation (DKK bn. 1)	861.6	904.0	945.4
No. of loans, end year (1,000)	2.534	2.393	2.247
No. of foreclosures (flow)	3.953	1.672	872

Source: The Association of Danish Mortgage Banks

**Figure 1.** Outstanding Loans of Danish Banks and Mortgage Banks, 1993 to 1996



Source: The National Bank of Denmark

**Table 2.** Credit Extension in Denmark to the Private Sector, Local Authorities, etc.

DKK bn	Banks	Mortgage Banks	Other Bond Issuers <sup>1</sup>	Abroad	Credit Extension, Total
1994	-39.6	7.3	6.4	-3.9	-29.8
1995	8.1	29.2	0.5	-8.5	29.3
1996	13.8	38.5	0.4	-0.7	52.0

<sup>1</sup> Comprises debentures, Kommunekredit, Danmarks Skibskreditfond, FIH, etc.

Source: The National Bank of Denmark and The Association of Danish Mortgage Banks

has been more than 90% of the total annual financing requirement against mortgages on real property. The commercial banks and savings banks play a minor role in mortgage financing.

In 1995 and 1996, aggregate lending expanded. In 1996, total new lending hit well

over DKK52bn, of which mortgage banks contributed almost DKK39bn (equal to US\$765m and US\$597m, respectively). Mortgage banks accounted for about 70% of the total credit expansion, due in part to the prevailing relatively low interest level. (See Table 2.)

This development can be ascribed to the 1994–95 rebound in the general economy, with the ensuing surge in earnings for business and the revival of optimism among consumers leading to a boost in activity on the property market. Compared to the boom in the early 1980s, however, lending developments were considerably more subdued.

**THE DANISH PROPERTY MARKET**

Prices of owner-occupied dwellings in Denmark rose in 1996. Compared to 1995, prices on the different property categories rose by between 7% and 10%. However, the price increases masked regional differences and seemed to peter out at the end of 1996. (See Figure 2.)

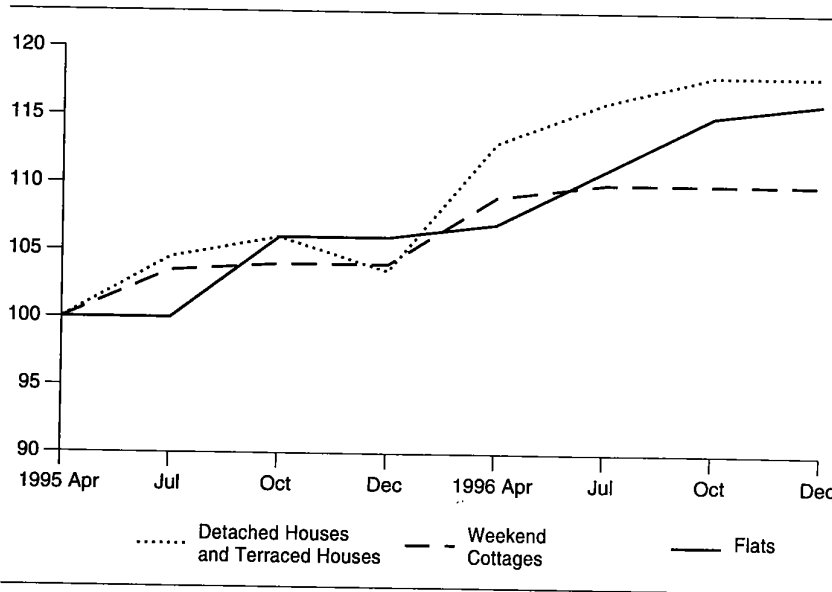
In recent years, the volume of house sales has remained at a relatively high level. New building has also taken a turn for the better. Thus, in 1996 total housing construction rose 20%. This development, however, should be viewed against the low level of construction in the early 1990s.

The number of announced compulsory house sales dropped by 28%. Developments in past-due payments, as recorded by mortgage banks, seem to underpin the belief that this favorable trend will continue. Thus, from 1995 to 1996 the ratio of accounts in arrears dropped from 0.46 to 0.35. Both these indicators seem to highlight the recovery in the general economy.

**MORTGAGE ACTIVITY IN DENMARK**

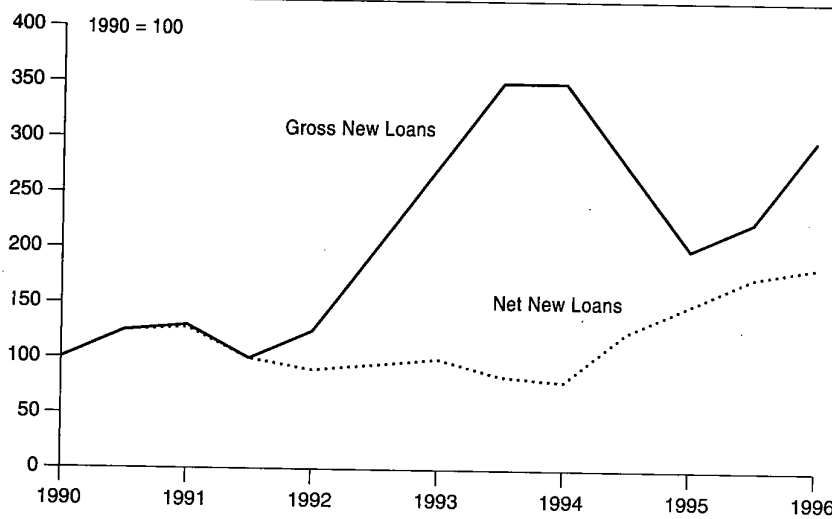
In 1996, gross new lending by mortgage banks amounted to DKK214bn versus DKK139bn in 1995 (equal to US\$33bn and US\$21bn, respectively)—a leap of more than 50%. This result reflected in particular the remortgaging wave during the first few months of the year. [Editor's note: Danish mortgage loans can be refinanced (remortgaged) by the borrower with no penalty. Danish mortgage bonds are thus callable. The magnitude of prepayment can

**Figure 2.** Price Development for Owner-Occupied Dwellings Since First Quarter 1995 (Index 1st Quarter 1995 = 100)



Source: The Association of Danish Mortgage Banks

**Figure 3.** Gross and Net New Loans of Danish Mortgage Banks, 1990-1996



Source: The Association of Danish Mortgage Banks

be seen by comparing the gross and net lending of the mortgage banks in Table 3.] In addition, the buoyant property market created major interest in mortgage credit financing. Demand has been mounting in all property categories; however, the most pronounced trend was experienced within gross new lending to industrial and trade properties on the one hand, and office and commercial properties on the other. (See Table 3 and Figure 3.)

Once again, mortgage banks recorded respectable performances in 1996. The loss ratio was halved compared to the previous year and is at an all-time low. Measured against total lending, losses amounted to 0.07% compared to 0.14% in 1995.

At the end of 1996, the average solvency ratio for mortgage banks was 13.1% compared to last year's 11.9%.

### THE DANISH BOND MARKET

As mentioned above, the lending of Danish mortgage banks is solely financed by the issuing of bonds.

The volume of trading in mortgage bonds rose by 45% in 1996 against the year before. This jump is explained by the swell in remortgaging activity and mounting interest from abroad in mortgage bonds, since in 1996 mortgage bonds issued by several mortgage banks were given satisfactory ratings by the Moody's bond rating agency.

At year-end 1996, the outstanding volume of bonds amounted to about DKK1,700bn (equal to US\$260bn), corresponding to 1.5 times the Danish GDP. Mortgage banks account for 55% of this volume, equal to just under DKK950bn (equal to US\$145bn). (See Table 4.)

The primary buyers of Danish mortgage bonds are still insurance companies and pension funds, which between them hold almost 40% of all mortgage bonds. Danish Government

**Table 3. Gross and Net New Loans of Danish Mortgage Banks Distributed on Property Categories**

DKK bn.	1994		1995		1996	
	Gross	Net	Gross	Net	Gross	Net
Residential						
Rental	36.1	9.3	17.4	11.1	24.0	11.5
Owner-occupied	141.1	26.7	83.8	31.6	115.3	5.1
Manufacturing						
Farms	34.8	2.0	14.2	5.4	24.0	4.4
Manual and manufacturing industries	11.2	-3.3	7.2	2.2	17.2	2.7
Offices and shops	31.8	-3.8	14.9	2.7	30.4	2.8
Other properties	3.5	0.1	1.5	0.6	3.6	1.1
Gross new loans, total	258.5		138.9		214.5	
Transfer <sup>1</sup>	-164.0		-49.2		-96.2	
Prepayments <sup>2</sup>	-63.5		-36.1		-54.2	
Net new loans		31.0		53.6		64.1
Ordinary repayments <sup>3</sup>		-23.7		-24.4		-25.6
Net loans		7.3		29.2		38.5

Note: For 1994 and 1995 the chart comprises BRFKredit, DLR, Danske Kredit, LRF, Nykredit, Realkredit Danmark, TOTALKREDIT and Unikredit. For 1996 it also comprises FIH Realkredit.

<sup>1</sup> Transfers comprise loans prepaid in connection with the payment of a new loan in the same mortgage bank.

<sup>2</sup> Prepayments comprise loans prepaid without a new loan being taken out with the same mortgage bank.

<sup>3</sup> Ordinary repayments comprise the repayments made in connection with the regular amortization of loans.

Source: The Association of Danish Mortgage Banks

**Table 4. The Danish Bond Market**

DKK bn.	Mortgage-Bonds <sup>1</sup>		Government Securities		Other Bonds <sup>2</sup>		Total	
	Year	Value	Year	Value	Year	Value	Year	Value
Volume in circulation <sup>3</sup>	1995	904.3	1995	649.6	1995	91.6	1995	1,645.5
	1996	945.4	1996	670.5	1996	95.4	1996	1,711.3
Gross addition <sup>4</sup>	1995	141.6	1995	234.9	1995	8.5	1995	385.0
	1996	214.6	1996	200.6	1996	18.3	1996	433.5
Net addition <sup>4, 5</sup>	1995	38.9	1995	32.6	1995	-1.5	1995	70.0
	1996	29.4	1996	19.3	1996	2.0	1996	50.7

Note: The table comprises bonds denominated in DKK.

<sup>1</sup> For index-linked bonds, the addition has been calculated at the indexed value at the time of issuance, whereas the bonds in circulation have been calculated at the indexed value at the end of 1996.

<sup>2</sup> Comprises bonds issued by Danmarks Skibskreditfond, KommuneKredit, etc.

<sup>3</sup> The volume in circulation has been calculated at nominal value.

<sup>4</sup> The gross and net addition, respectively, have been calculated at market value.

<sup>5</sup> The net addition is defined as the gross addition of bonds less drawings and other elimination of bonds.

Source: The National Bank of Denmark and The Association of Danish Mortgage Banks

**Table 5.** Investor Distribution on the Danish Volume of Bonds in Circulation

<i>End 1996 Distr. in %</i>	<i>Mortgage Bonds</i>	<i>Government Securities</i>	<i>Other Bonds<sup>1</sup></i>	<i>Total</i>
Financial institutions <sup>2</sup>	17	23	20	20
Insurance and pension funds	37	7	31	24
Public sector <sup>3</sup>	16	18	17	17
Other trades	9	7	6	8
Households	11	7	19	10
Foreign <sup>5</sup>	35	3	17	
Undisclosed	5	3	4	4
<b>Total 100</b>			<b>100</b>	
Volume of bonds in circulation, DKK bn.	945.4	670.5	95.4	1,711.3

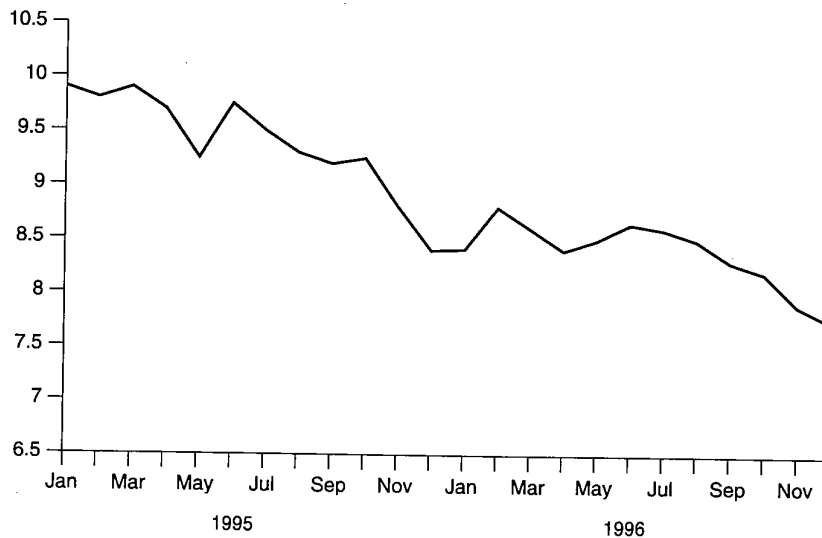
<sup>1</sup> Other bonds comprise debentures and bonds issued by KommuneKredit, Danmarks Skibskreditfond, et al.

<sup>2</sup> Including the National Bank of Denmark

<sup>3</sup> Including the central and local government sector, the Labour Market Supplementary Pension Scheme, The Social Pension Fund, etc.

Source: Danmarks Statistik

**Figure 4.** Interest Development for 30-Year Danish Mortgage Credit Bonds, 1995-1996



Source: The National Bank of Denmark

bonds remain the favorite of foreign investors, who hold almost 40% of all these bonds. (See Table 5.)

Danish interest rates have been declining since 1995, and during the past two years the leading interest rate has dropped by more than two percentage points. (See Figure 4)

#### MORE INFORMATION

More information about the Danish mortgage market can be obtained from:

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