Dutch Guarantee Fund for homeownership; model for a single Guarantee Fund for the European Union?

Lecture held by Karel Schiffer, CEO of the Mortgage Guarantee Fund for Homeownership in the Netherlands

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Ladies and gentlemen,

It is an honour and a pleasure for me to inform you today about the mortgage guarantee system in the Netherlands. In the spirit of the conference, I will consider this system in the context of the European Union.

Before I go into detail, I would like to draw your attention to the following.

If I ask you to name some typical features of Dutch society, you're bound to mention tulips, windmills, clogs and, of course, coffee shops.

You've probably already forgotten the historical successes of the Dutch football team, as we didn't manage to qualify for the World Championship that was held this year. You're unlikely to say that the Netherlands are famous for their mortgage guarantee fund for homeownership. However, this is one aspect that certainly sets the Netherlands apart from other countries.

In the coming fifteen minutes I intend to change your impression of the Netherlands completely. After my lecture, you will remember the Netherlands solely as the country with the successful mortgage guarantee system for homeownership.

I will start by giving you a short historical overview of Dutch housing policies, and the workings and benefits of the guarantee system.

After that, I will discuss whether the Dutch guarantee system could serve as a model for the European Union.

Housing policies promoting homeownership

In the Netherlands in the mid-1950s, encouraging homeownership was a burning issue in government of the day. At that time, privately-owned homes made up about 15% of the total housing stock, and were owned by wealthy people.

Based on a public policy document issued at the time, three financial instruments were introduced to promote homeownership:

- Mortgage interest deduction;
- Subsidies for home purchases;

- Mortgage guarantee.

Thanks to the positive effects of these instruments, homeownership has now risen to 53%. At the end of this decade, the Dutch Ministry of Housing expects a further increase to a total of 65%. Unfortunately, it appears that the number of houses being built are far too low to meet this expectation. The only way to achieve this target is by selling off an larger volume of rental dwellings, most of which are concentrated in the social rental sector.

I will now trace a brief history of the mortgage guarantee.

From Municipality Guarantee to National Mortgage Guarantee

In 1957, the Dutch mortgage guarantee was designed as a central government and municipalities guarantee. Each party had an equal, fifty/fifty share in the debt risk. This was called the municipality guarantee with central government backing.

Because of the risk transfer of credits from lender to government, lenders were not obliged to keep reserves on their balance sheets. Thanks to this so called ‘zero solvency’, borrowers received an interest advantage up to 50 basis points beneath market rates. Besides, there was another advantage. Before 1957, risk-averse behaviour of lenders prevented giving borrowers a 100% mortgage for the purchase of their own home. A down payment of at least 30% was required in those days. The introduction of the municipality guarantee obviated the need for a down payment.

As municipalities were free to set their own conditions, each municipality had, in practice, its own set of conditions. Moreover, the assessment procedure took a lot of time. Despite these inefficiencies the guarantee system worked well, thanks to a booming economy. Related to rising home prices, there was hardly any exposure to a borrowers’ default. This situation lasted until the beginning of the 1980s. Unfortunately, the Dutch economy then went into a recession. Home prices dropped dramatically, long-term real interest rates increased and unemployment figures exploded. Under those conditions, it did not come as a surprise that the number of defaults augmented enormously.

Together with the central government, the municipalities encountered a great many problems paying debt claims to lenders, as municipalities and central government had forgotten to start creating reserves from the onset.

These weaknesses in the structure of the municipality guarantee prompted local and central government to evaluate this system. All this led to the governments’ decision to make the mortgage guarantee self-supporting. This was done by means of a guarantee fund construction. Uniformisation of rules, efficiency in the fund operations and solid capital fund management formed the main input for the new framework.

This resulted in the foundation of the Guarantee Fund for Homeownership. We call this product - introduced on the first of January 1995 - the ‘National Mortgage Guarantee’.

The aim of this National Mortgage Guarantee is to promote homeownership especially among lower and middle-income groups in the Netherlands. The National Mortgage Guarantee can be granted for mortgage loans aimed at purchasing homes valued up to 200,000 euro.

Organisation

The Guarantee Fund is a private non-profit organisation whose board of supervisors consists of representatives from central government, the association of municipalities (VNG), the union of financiers (NVB) and the national consumers’ association of owner-occupants (VEH). The fund has in this way the full confidence and credit of both local and central government and market parties involved.

Backing of central government and municipalities

Without doubt the only way that the National Mortgage Guarantee Fund has reached her successful position in the market was by having the financial support of central government and municipalities. Both central government and municipalities support the Guarantee Fund with subordinated interest free loans in case fund reserves drop down below a certain limit. Through this backing the Dutch Central Bank considers the National Mortgage Guarantee as a government guarantee.

Having the full confidence and credit of the government, lenders favor a zero solvency for loans supplied with the National Mortgage Guarantee. It is needless to say that this is the key issue of the guarantee system.

Consequently central government and municipalities exercises close supervision on the fund. For example, each year, modifications in the standards and terms require the approval of the government.

I have to say that the governments’ backing is in normal conditions a theoretical one. Our basic assumptions is that the funds’ liquidity are adequate to fulfill debt calims on basis of sound actuarial calculations.

Fund reserves

The reserves of the fund are as you will understand another cornerstone of the guarantee fund. They are built up by means of a fee the borrower has to pay as a single upfront fee. For 2002, this fee has been set at 0,3% of the loan amount. The fee is calculated on an actuarially sound basis such that government risk bearing has been compensated as I have told you already.

From the start of the fund in 1995 a fund capital of about 220 million euro has been built up. This covers the risk of a nominal amount of about 40 euro billion in mortgage loans. Because we encounter very few losses funds' reserves accumulate until now, each year with nearly 30 million euro. Favourable economic conditions in the past contribute mainly to these minor losses.

Delegating the assessment procedure to lenders

The guarantee system functions in a setting that we call repressive supervision. The whole assessment operation has been delegated to lenders. This can only be done if a deed of suretyship exists between the lender and the fund. To conduct the assessment properly, the foundation provides lenders the standards and terms.

The fund control function is activated when it comes to handling debt claims. In the event of a risk default, the owner-occupant is forced to sell his own house. If the revenue is insufficient to recover the outstanding debt, the lender will claim the remaining mortgage debt. Then the lender will send the file in question to the fund to check whether the lender has acted in accordance with the standards agreed upon when the loan was offered. This system of repressive supervision makes it possible for us to do our job with a small but high-quality organisation comprising just 20 employees.

Standards and Terms

Supplying a mortgage guarantee takes place on the basis of a set of uniform standards and terms. Most of the standards are a consequence of constructing an environment aimed at avoiding misuse and overindebtedness. The main standard is that cost of housing is in due proportion to the household income. We call this 'the home expenses-to-income ratio'. Each year a research institute is asked to calculate that ratio to be sure that a guaranteed mortgage loan is synonymous with safe and sound borrowing.

Benefits for all parties

Through the Guarantee Fund construction with the full backing of the central government and municipalities a unique situation arose that all parties like consumers, lenders and government will benefit.

Borrowers favours from the credit risk transfer by getting a 100% debt finance for the purchase of their homes. Moreover they enjoy a spread advantage on interest rates up to 50 basis points. And because of the standards and terms safe and sound borrowing is assured. Finally, in case of a foreclosure, a remaining debt will be remitted if the borrower did behave as a good housekeeper to do everything to limit this debt.

Lenders can take the opportunity to expand their credit supplies to borrowers because of the guarantee. Thanks to the zero solvency they can improve their credit risk performance. Moreover, lenders may consider the standards and terms as a benchmark leading to a lowering of information costs.

For the government, the National Mortgage Guarantee constitutes an institutional guarantee that improves the affordability of housing for lower and middle-income groups and makes safe and sound borrowing possible.

All together, about 60,000 households gain from granting the National Mortgage Guarantee each year on a potential volume of about 120,000 first mortgages. So within our limits roughly 50% of the home purchases in the Netherlands is financed with a National Mortgage Guarantee.

Macro economic relation

A growing owner-occupied housing sector and a simultaneously increasing mortgage market like in the Netherlands means that both markets will be more involved in the prerequisites for a steady economic growth. So the guarantee can be helpful in stabilising fluctuations in the economy. Dutch research on the wealth effects of the owner-occupied sector confirms that economic growth can be substantially influenced by the housing and mortgage market.

I think that there is plenty of opportunity to demonstrate the pros of the Dutch guarantee model abroad. So it was not a suprise to me that countries are interested in the Dutch guarantee system escpecially countries in the transition phase. Furthermore the introduction of the Euro this year, together with the single monetary policy for the European Union give me an important reason to present the guarantee model in Madrid.

National Mortgage Guarantee, a model for the EU?

So looking at the benefits of such a guarantee system and keeping in mind my enthusiasm about this system it would seem logical to ask the following question - is there any chance to putting the model of the Dutch Guarantee Fund onto a higher plane such as that of the EU? The answer of course is not a simple one.

In my opinion, the first steps to be taken is to convince both governments and the European Commission that it would be wise to promote such a system. I am, of course, counting in years rather than days before the time is ripe for introducing a European-oriented guarantee fund. And if the answer is ‘yes’ the question is how to organise it.

In my view, there are at least two ways of setting up a mortgage guarantee system in the EU.

The first is to create a system of nationally-organised mortgage funds. In such a system, each country would have its own fund and its own procedures adjusted to the features of its own, national mortgage and housing market. It is of utmost importance here to have a backing of the national government.

The second way of designing a guarantee system can be embodied in a so-called business model. That means the creation of a single mortgage guarantee fund for the EU. This centralised organisation with a centralised organised capital fund management has its local units in the different member states of the EU. Of course national government backing of this guarantee fund is a crucial condition for a successful implementation.

At this current stage of brainstorming, details about how to implement such a system are of lesser important.

But given the many differences in government policies, legal procedures etc. may be it would be wise to start with the first way namely nationally-organised guarantee funds. Later on these funds can come to a closer cooperation by means of a federation of guarantee funds in the EU.

Conclusions

I have outlined the workings and the significance of the mortgage guarantee system for homeownership in the Netherlands. In the long history of this system, the guarantee has grown from a traditional bureaucratic system to become an efficient and effective one. But those elements that have been retained constitute a very practical and reasonably cheap instrument for the benefit of homeownership.

In addition I have introduced the idea how to set up a European-scaled guarantee fund.

This might be important for all European citizens and especially those with lower incomes in order that housing is both available and affordable, at the lowest possible costs of capital. Further it will for sure contribute to let work mortgage markets in the EU more effectively and more efficiently.

It goes without saying that I am willing to discuss this subject on a national as well as on a European level. And of course I am prepared to advise governments how to found a lookalike system.

I thank you for your attention.