Cambridge Centre
for Housing &
Planning Research

The future of housing finance – lessons from the UK?

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Sound housing finance around the world

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UNIVERSITY OF
CAMBRIDGE

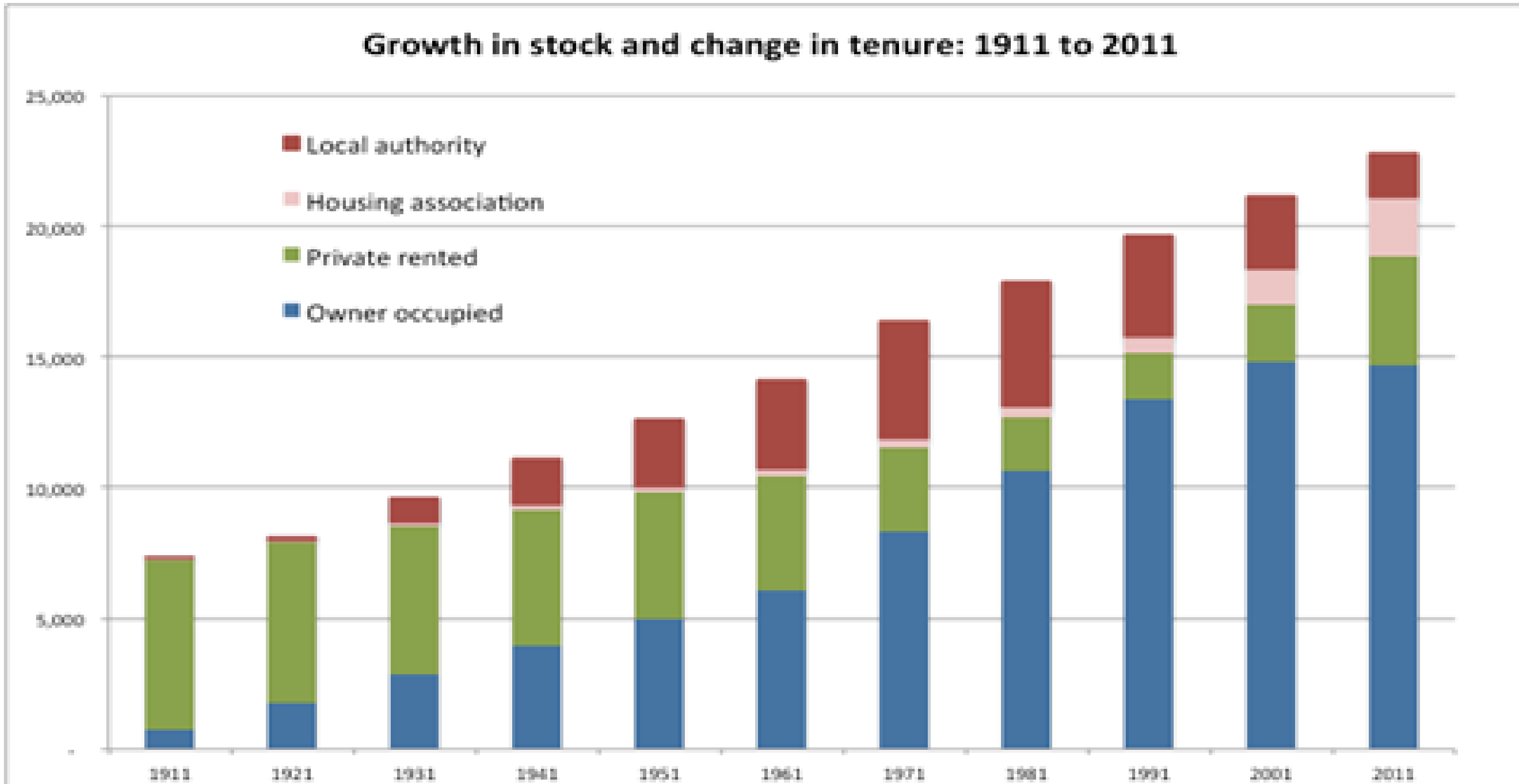
My presentation

- Speaking to a very expert international audience with all the risks that entails!
- This is one of the most challenging environments in which to take forward the housing finance market. A combination of difficult economic conditions, more complex and demanding regulation, consumer challenge and change and the demands of governments put the industry at the centre of the veritable storm
- At the same time acceptance that housing is a key driver in the economy and that where necessary market must be supported
- But in the UK and elsewhere falling home ownership brings politics firmly into the equation

My presentation

- Begin by looking at what has been happening in the UK and where the housing market and housing finance might be going
- Then want to reflect on that and talk about underlying issues and trends
- Before concluding with some questions and generalisations about global trends.

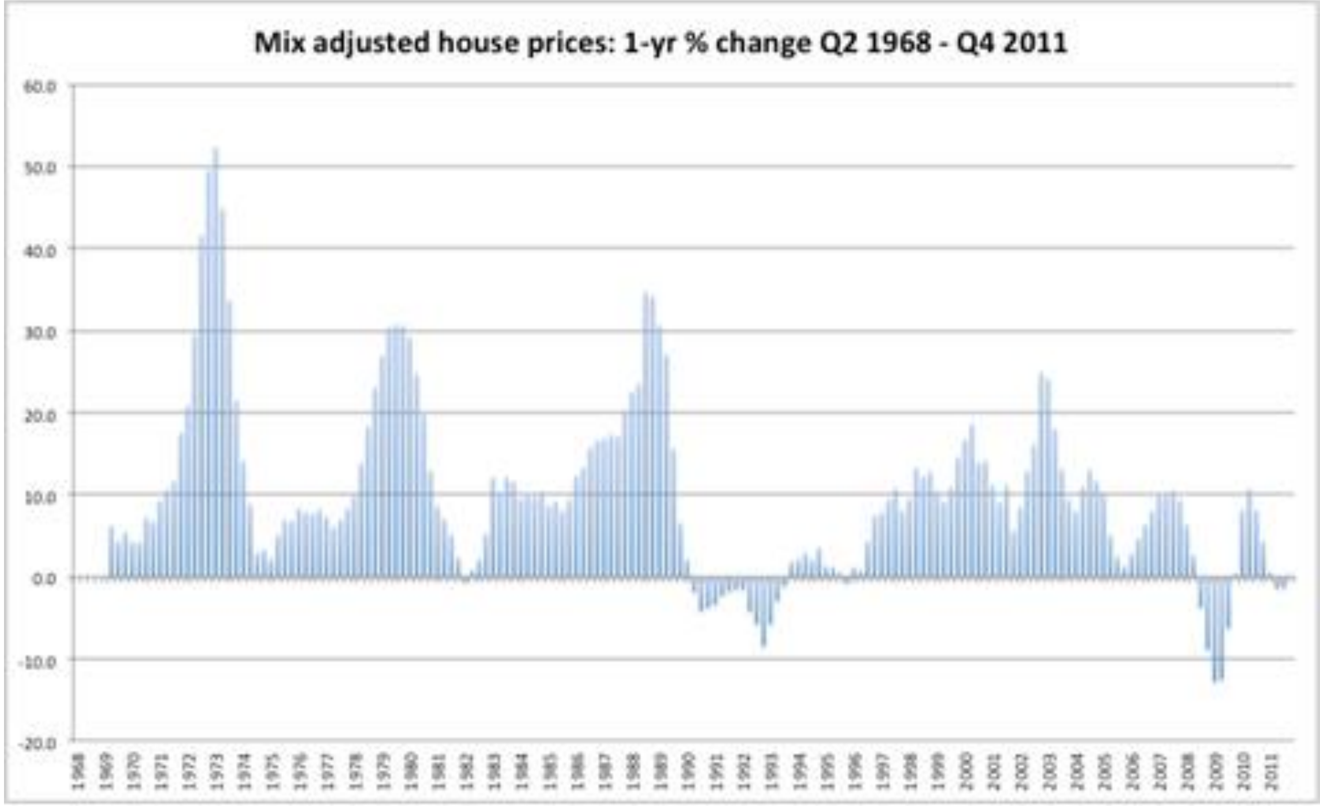
UK housing; looking back



UK housing; looking back

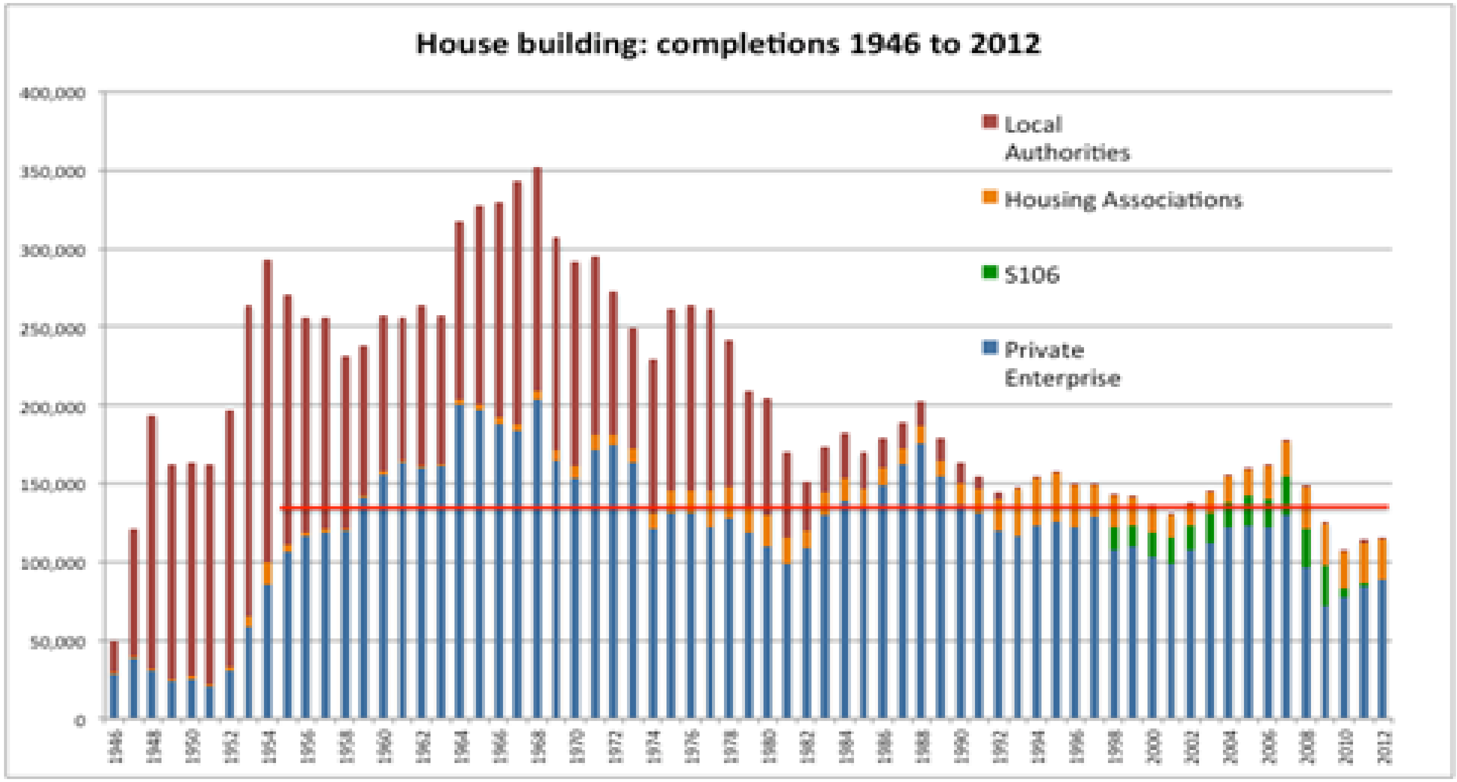
- Slide tells us – change happens – there are probably no givens
- Indeed global comparisons make that point
- In the UK we are in the midst of a change process – more renting, less owning
- Or are we – will government arrest the market processes?
- Increased support for housing finance
- Slide also tells us the somewhat narrow base of housing provision in UK given moving to a more diverse population in terms of household size (ageing, more single people, fewer families, plus less certain employment)
- Much of what we observed was fuelled by two incomes

Boom and Bust! Volatility



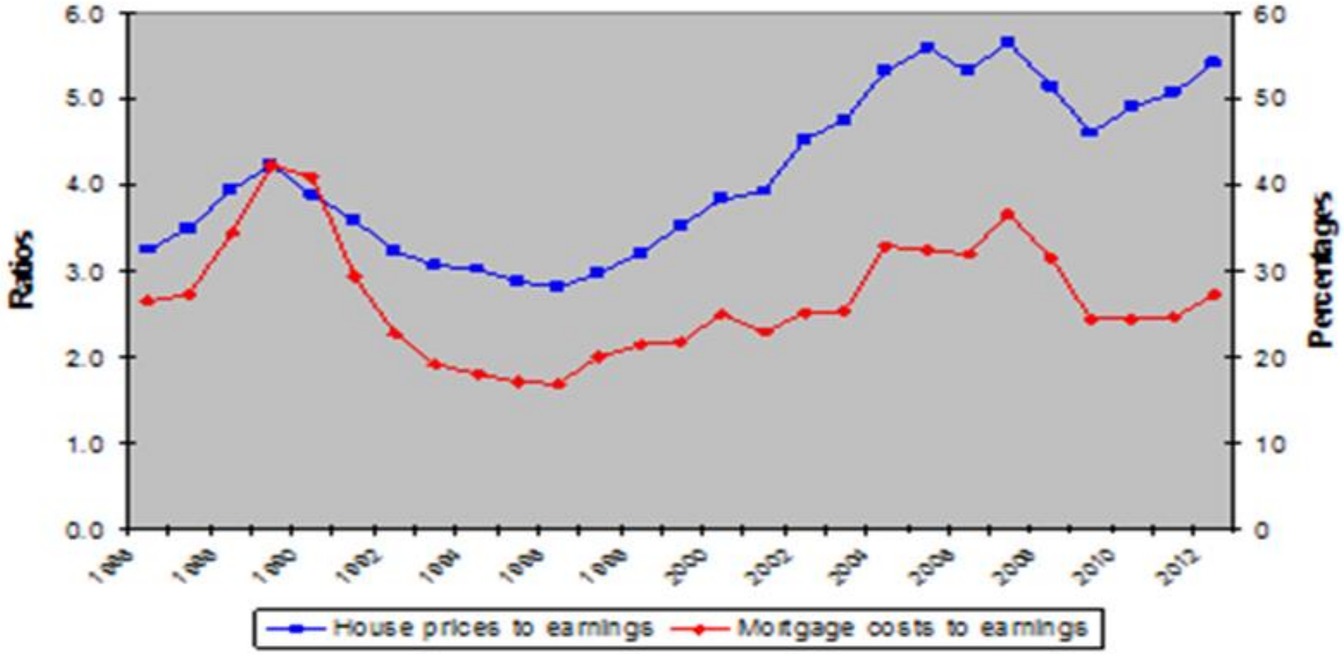
Prices and earnings

Housing supply



But LTI lower

Housing market affordability in Great Britain

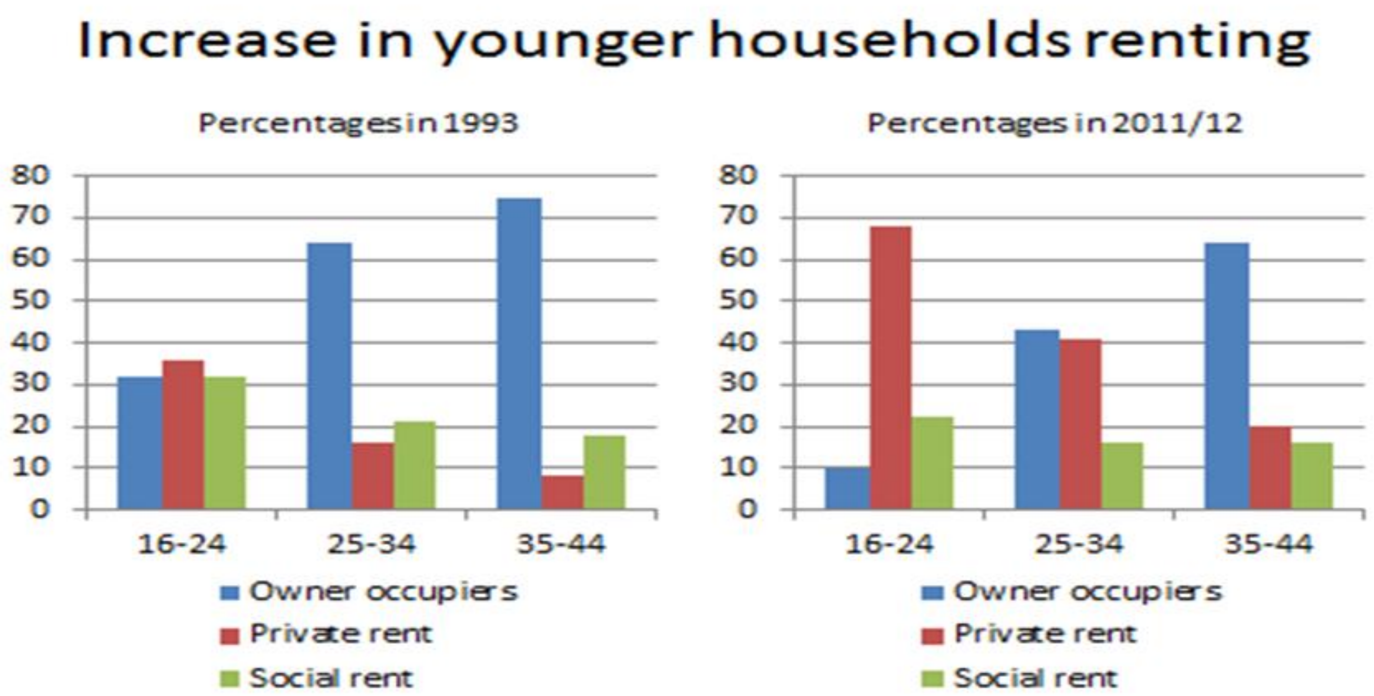


All full time earnings and first time buyer mix adjustedhouse prices and mortgage advances.

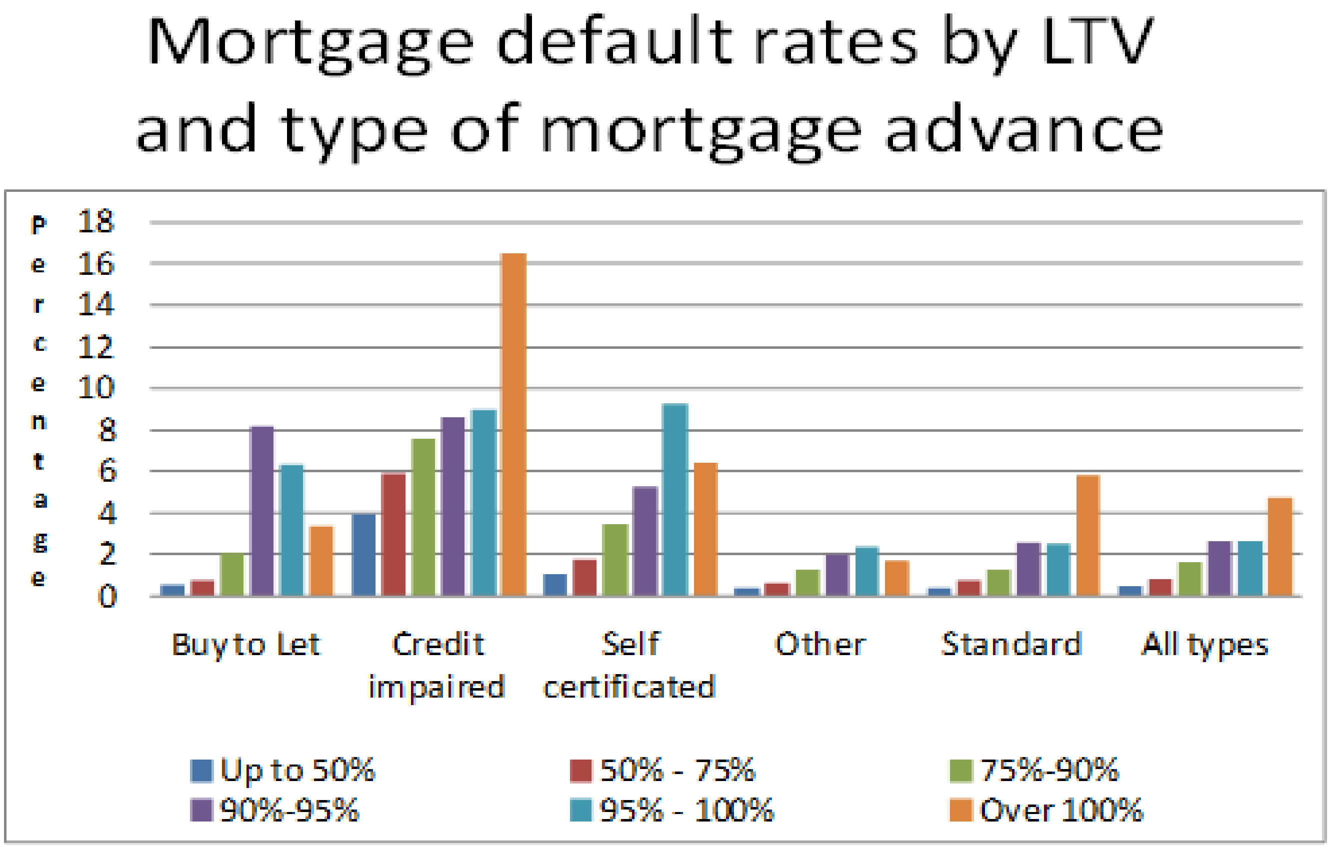
High LTV loans for FTBS by year and LTV percent (CML)

	90-94	95-99	100+
2006	25%	24%	5%
2007	23%	25%	6%
2008	23%	16%	4%
2009	16%	1%	0%
2010	18%	1%	0%
2011	18%	1%	0%
2012	19%	2%	0%

Choice and Preference?



LTV, product type and default



Source : FSA Mortgage Market Review. Default rates for 2008.

The UK market

- Characterised by continued market volatility
- Supply weak and despite planning reform it remains weak
- Prices high relative to earnings but LTI improved
- Importance of high LTV loans
- Consumer confidence very low and finances under strain
- Lack of mortgages forced switch in consumer/lender behaviour
- Changes in product types and risk appetite
- Cyclical adjustment but structural too in terms of regulation etc
- Overall mortgages performed relatively well

The UK market

- Government/Bank stepped in – variety of ways
- Lower interest rates – and continuing
- Support for borrowers in difficulty,
- NewBuy, Help to Buy1 and 2, Rental fund and Funding for Lending schemes – all aimed at increasing funding, stimulating supply of homes and higher LTV loans
- In total roughly £40 billion of support so far; time limited
- Sudden conversion to mortgage guarantees – untested!
- Increased regulation (MMR), tighter controls on products and suitability and rules around particular products (e.g. interest only)
- Distrust of capital market funding limit on future credit

The UK market

- UK market was deflating – question where now?
- Good politics, poor economics?
- Back to the past or not?
- Clearly regulation, product control and tighter funding regimes more reliant on retail poses limits?
- We wait to see – direction of policy unclear
- Governor of BoE commented recently "I'm sure that there is no place in the long run for a scheme of this kind" and

  "We do not want what the United States have, which is a government-guaranteed mortgage market"

Thinking internationally

- Turn now to a selection of comparisons and issues before moving to a concluding section on where housing finance may be going
- Mixture of countries – depending on what available
- Sources still a challenge – Eurostat, EMF, BIS, IMF, OECD, ENHR, Hofinet, plus the new interest in global housing markets
- Plus of course global responses to the financial crisis so contributions from Reserve Banks, Financial Stability Board,
- Comparisons are complex because of the differences whether in taxation, property law, consumer law etc. and time lags in data availability let alone definitions!

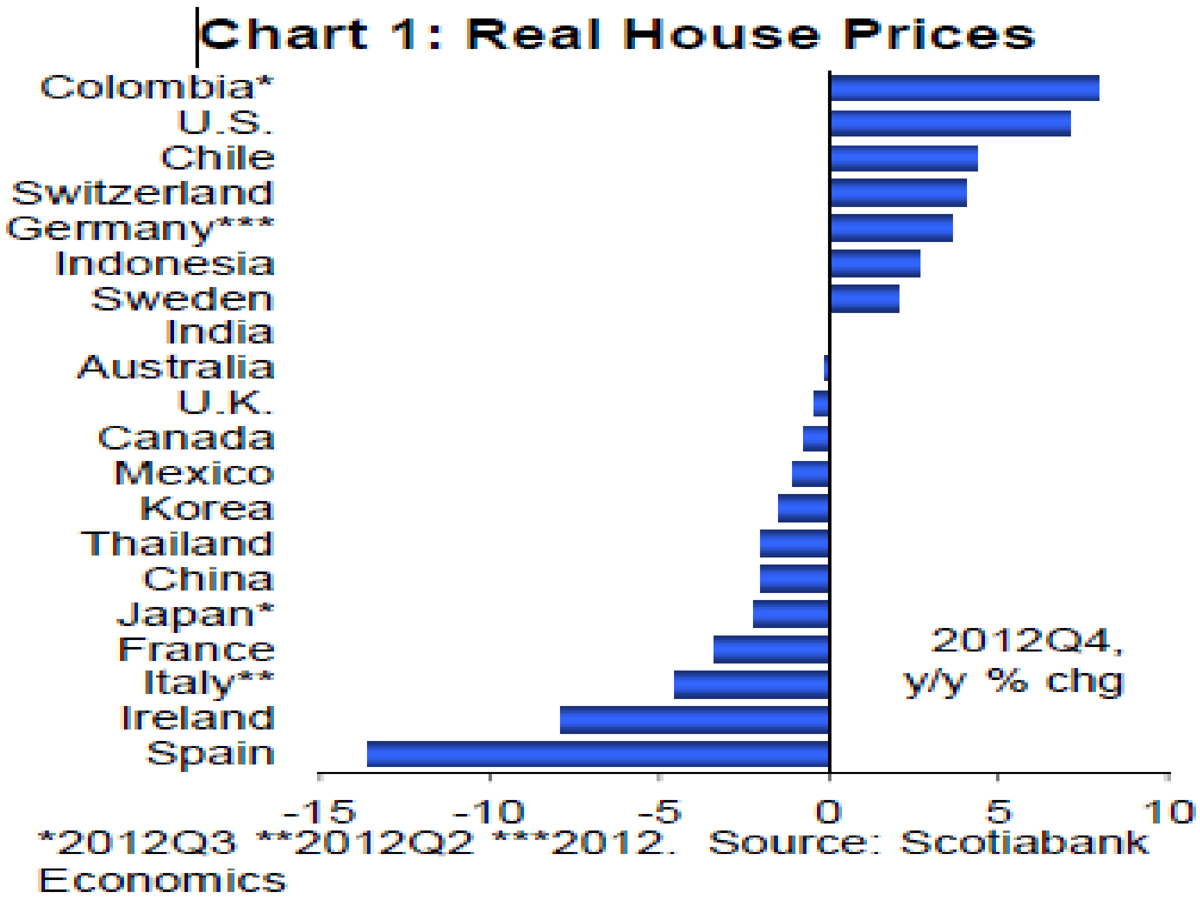
The Economist house-price indicators

	Latest, % change		Under(-)/over(+) valued, against*:	
	on a year earlier	since Q4 2007	Rents	Income†
Hong Kong	24.5	109.4	81	*na*
Brazil	12.8	*na*	*na*	*na*
South Africa	11.1	18.0	-2	10
India	10.7	88.8	*na*	*na*
United States	9.3	-20.8	-8	-21
Singapore	3.5	24.8	57	*na*
Germany	3.4	9.7	-17	-17
China	3.3	20.4	6	-35
Sweden	3.0	10.0	31	17
Australia	2.6	12.2	44	24
Canada	2.0	18.3	73	32
Britain	0.9	-11.4	19	11
France	-1.7	1.1	39	34
Japan	-2.6	-14.2	-37	-36
Ireland	-3.0	-50.2	-1	-5
Italy	-4.0	-11.3	-2	10
Netherlands	-7.0	-16.5	6	33
Spain	-7.7	-26.5	15	16

*Relative to long-run average †Disposable income per person

Sources: BIS; Haver Analytics; Hong Kong RV; National Housing Bank; Nationwide; OECD; Teranet and National Bank; Thomson Reuters; *The Economist*

Global house prices



Comparing markets

- Economist suggests some countries, e.g. UK, are over-valued
- UK government policy was implicit deflation and since 2008 25% fall in real terms and flat in nominal terms
- But now supporting price increases
- Elsewhere policy more consistent - US where prices negative?
- As a generality prices fell post crisis but timings/recovery vary
  - Group 1; UK, Denmark, Spain, Ireland, Netherlands – nominal and real falls some stabilisation
  - Group 2; US, Finland, France, Sweden - more limited decline, some recovery, some reversal
  - Group 3a; Norway, Belgium, Canada - real price growth, slow recovery
  - Group 3b; Germany, Switzerland – relatively stable real prices

Changes in availability of mortgage products January 2009 – May 2011 (alphabetical by country in each group)

	Interest-only	*High LTV*	*Long terms*	*High loan-to-income*	*Reverse*	*Other*
Group 1: Prices falling						
Denmark	Up	No change	No change	Credit evaluation tightened	Not common	Fees increased by some banks
Ireland	Down	Down	No data	No data	No data	
Netherlands	Down	Up		Down		
Spain	Not available	Down	Down	Down	Up	
UK	Down	Down		Credit evaluation tightened	Little change	
Group 2: Double dip						
Australia	Up	Down		Little change in equivalent metric	Little used	
Finland	No change	No change	No change	No change	No change	No change
Group 3: Prices rising						
Belgium			Down		Not legal	
Germany	No change	Down	No change	Down	Up	
Norway	Down	Down		Down		'Frame loans' limited
Group 4: Unclassified						
Austria	Down	Down	Max 20 yrs	Limited availability	Little demand	Foreign currency loans down.
Czech	Down but not much used	Down	No change	Down	Not legal	Self-certification down
Poland	Not available		Not available			
Portugal		Down	Down	Down	Not available	

Source: Country experts

LSE

Post the GFC

- As a generality – tightening of regulatory controls on lenders and housing markets but landing on a highly differentiated landscape
- Analysis suggests;
  - Quality of Regulation made a difference as did speed of response
  - Global linkages played a part –made systems more vulnerable
  - Small but frequent intervention kept systems going
  - Previous history of bubbles helped!
  - Full recourse and no tax deductibility reduced scale of problem
  - But housing still national/local

Funding Models through the GFC

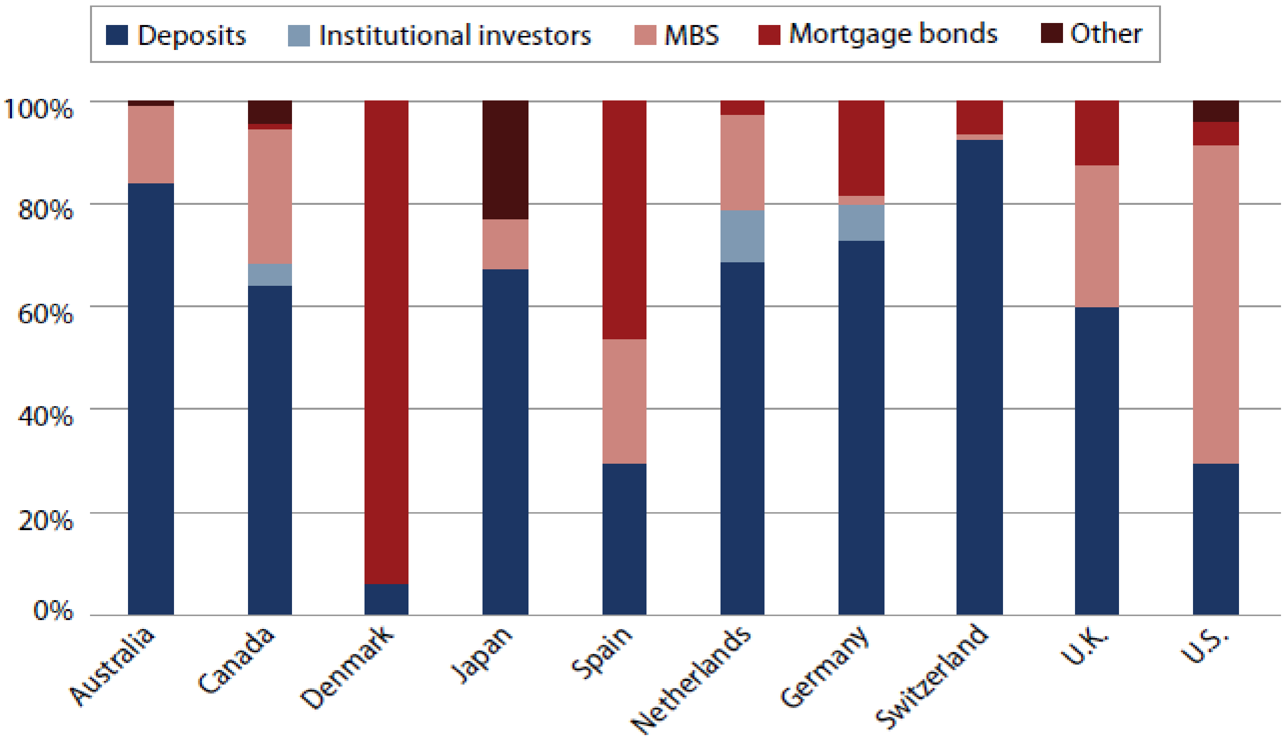
- Mortgage systems vary as does allocation of risk
  - Deposit financed lending –retail funds, asset/liability mismatch and interest rate risk
  - Securitised lending –loans packaged and sold to investors – information asymmetry plus range of risks but asset/liability match
  - Covered bonds – loans packaged and sold to investors but with significant call on originator lender – better asset liability matching?
- As a generality deposit and covered bonds have performed better than securitised though no problems in UK RMBS?
- But retail has inevitable limits. In UK BoE FLS scheme has limited bond issuance and in turn slowed recovery of debt issuance markets

Funding Diversity

FIGURE 2

Sources of mortgage finance are different in Europe

Mortgage funding channels in select European countries



Source: Michael Lea, "International Comparison of Mortgage Product Offerings," Research Institute for Housing America (2010)

Funding models through the GFC

- Securitised funding tighter regulation
- Impact on competition – squeeze on securitised impacts non banks - impacts product and service innovation
- Low interest rates and government intervention brought deposit rates down thus slowing retail funding
- Where is this perfect place? Move away from closed circuits of housing finance partly to secure more innovation and competition
- But the price is greater risk exposure and the need for more and complex regulation?

Future thoughts and conclusions

- Housing finance systems been severely tested and some have shown serious weaknesses
- General move to great conservatism not least as a response to tighter regulation
- Scale of failure was big but most borrowers kept going so question as to how big?
- Greater conservatism poses questions about future shape of markets and balance between owning and renting.
- If that boundary is drawn tighter and lower (i.e., more renters) more demand for products around the low cost home ownership and other transition products from renting to owning

Future thoughts and conclusions

- In UK we are seeing increases in shared ownership, shared equity, family mortgages, partnership mortgages, co-investment and equity loans. Experience elsewhere?
- But in reality are they market transformative – think not?
- Reality of mortgage markets is limited number of mainstream products around fixed/variable rates – understood by all?
- Combinations and flexibilities but even here failure to think outside box - base rate trackers, unmatched 30 year fixes
- The use of guarantees is widespread and shares risks
- Role of government was reducing but now increasing?
- Who benefits from housing subsidies – typically existing owners?

Future thoughts and conclusions

- Ultimately housing finance systems in place to bridge gap between cost of housing and capacity of households to pay for it
- Renting or owning is first cut through this and then combinations beyond
- This then opens up the question of the role of government to assist process via subsidy, tax treatment, regulation
- We have seen finance markets move from local to global and regulation has followed
- However as next make clear there are no guaranteed relationships between intervention and outcome

The relationship between regulation and size (in or near 2000), private renting

Degree of regulation		Size of the sector	
Low			Large
	England		Switzerland (55%)
	Finland		Germany (49%)
			France (21%)
Medium			Medium
	Norway		Norway (17%)
	France		Sweden (17%)
	Ireland		Finland (16%)
	Spain		England (13%)
Strong			Small
	Netherlands		Netherlands (10%)
	Germany		Ireland (9%)
	Switzerland		Spain (8%)
	Sweden		

Future thoughts and conclusions

- Governments been willing/forced to intervene – mortgage modifications and court procedures
- Managed down arrears and defaults not least as part of wider economic recovery measures
- And now focus still on housing and recovery with a lack of clarity as to long term view of housing market and housing finance
- Is it more of the same or a new future?
- And what has been done to address volatility and overconsumption of housing? Taxation agenda muted but…
- Underlying risks remain
- What does the industry want?

Future thoughts and conclusions

- Even if the industry is uncertain as to direction so too are governments
- Reluctance on product intervention and taking control of markets but….
- Housing markets increasingly private – renting or owning and less direct government provision of housing
- But more indirect intervention and likely to continue through slow recovery – ending up with state managed housing markets?

Questions and comments

- Thank you for your time
- Left with more questions than answers
- Is the UK experience odd?

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