



BIS Committee on the Global Financial System Meeting

# European Mortgage Markets in a Changing Environment

16 March 2005

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European Mortgage Federation



# European Mortgage Federation

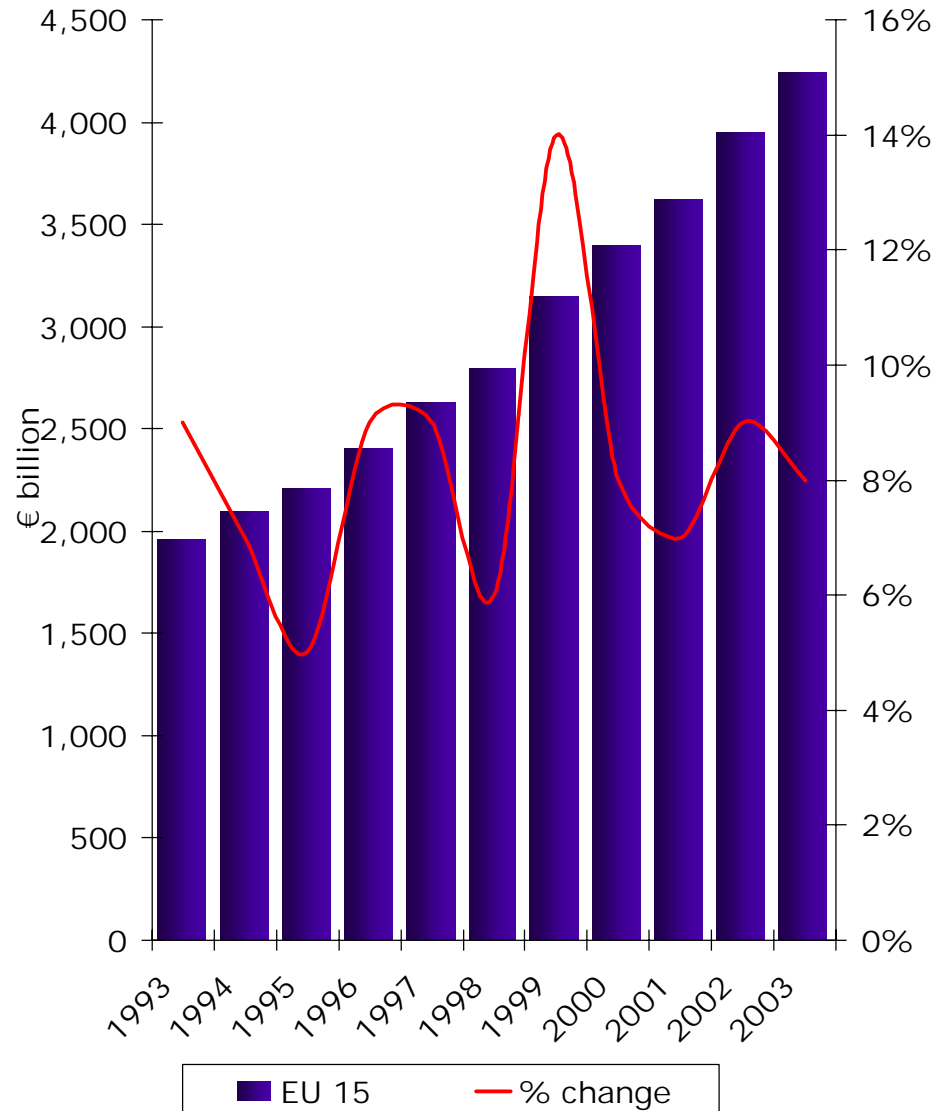
- European association founded in 1967
- Represents the interests of mortgage lenders
- Brings together mortgage lenders from EU countries and Switzerland
- New EU countries membership: Czech Rep., Hungary, Poland & Latvia
- Represents over 75% of EU mortgage market



# Market Trends

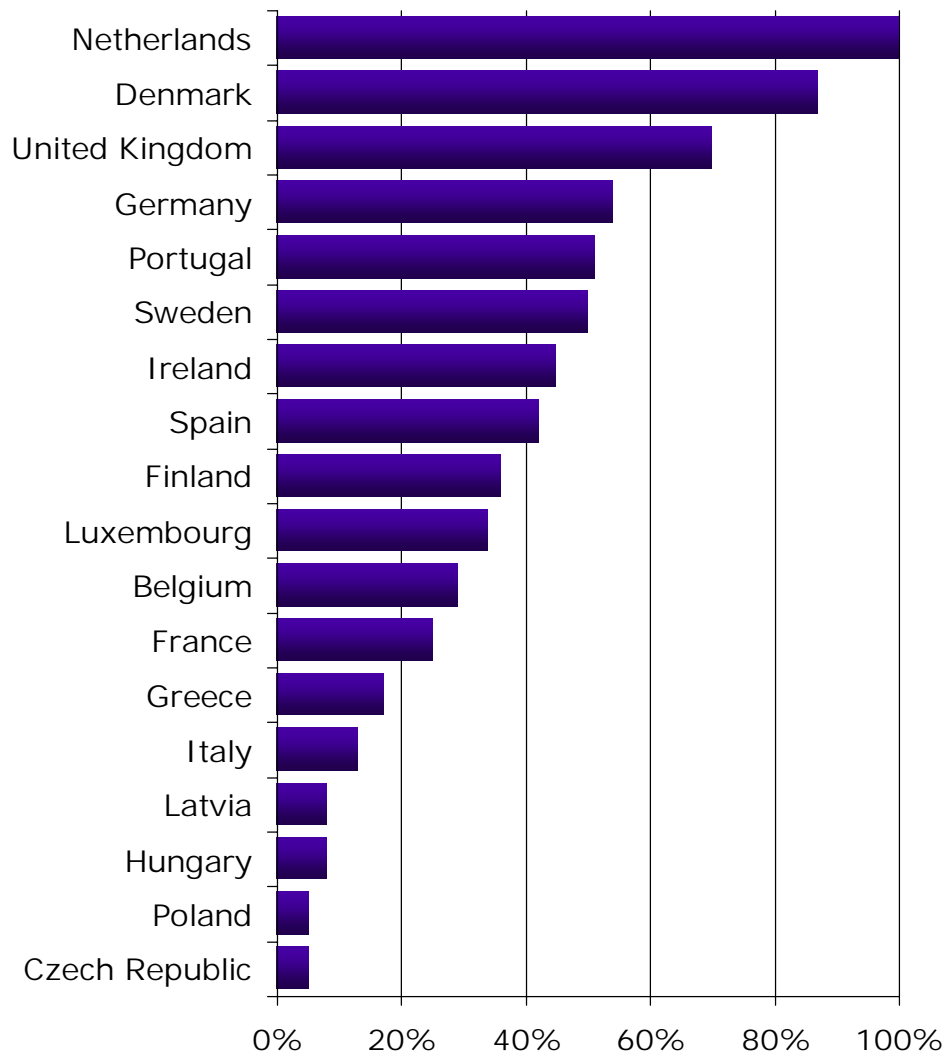
- **Stock:** Total value of outstanding residential mortgage loans EUR 4.2 trillion at end 2003
- **Growth:** Average annual growth rate approx. 8% per year over the last 10 years
- **Rates:** significant falls in mortgage interest rates since the introduction of the Euro have stimulated the markets
- **House prices:** prices have increased in most countries
- **Funding:** having access to both securitisation and/or covered bond is becoming an increasingly competitive issue
- **Regulation:** Capital adequacy and European integration dominate the regulatory agenda

# Value of EU Residential Mortgage Market 1993-2003



- Over €4.2 trillion in debt outstanding as at end 2003
- Growing at an average rate of 8% per annum
- Market has more than doubled in size over past 10 years
- US total debt 50% higher at around €6 trillion for end 2004.

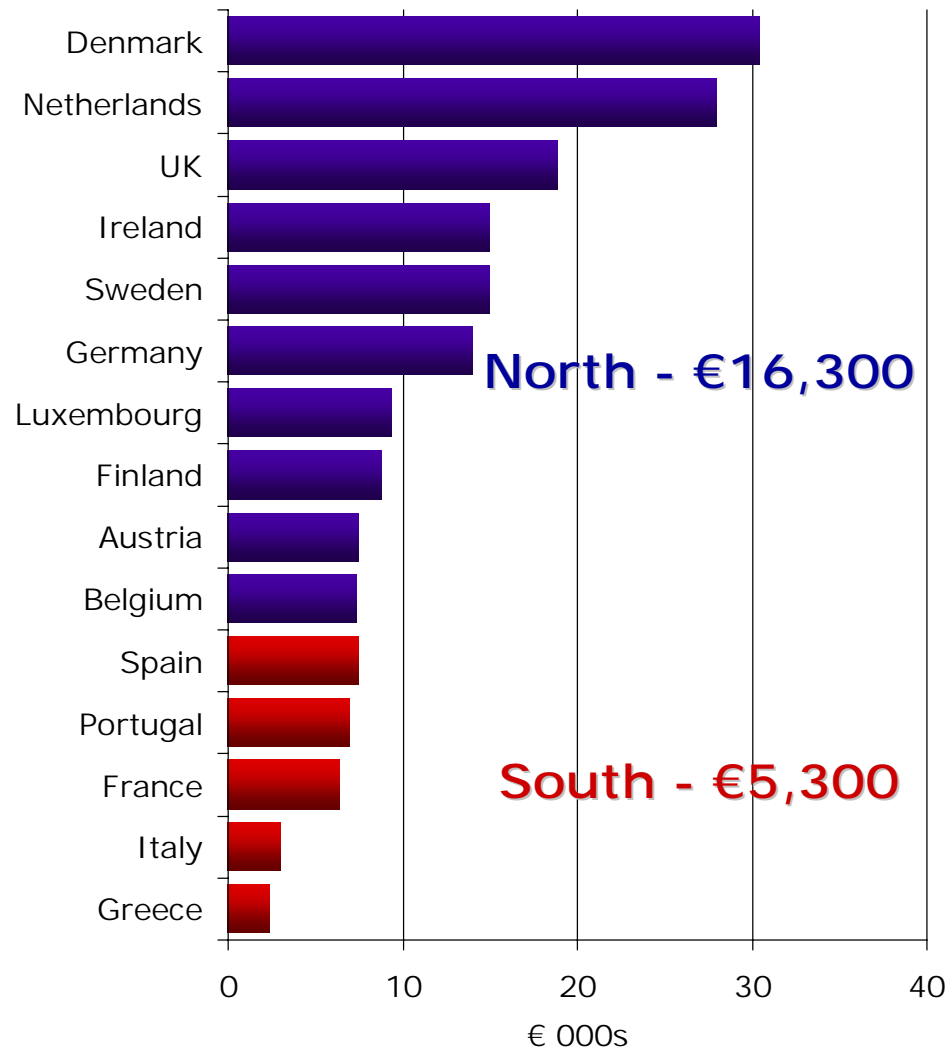
# Mortgage Debt as % of GDP - 2003



Source: European Mortgage Federation

- European average around 45% of mortgage debt to GDP
- Mortgage debt represents around 2/3 of total household debt in Europe
- US debt to GDP around 71% but benefits from state guarantees
- New member states only around 5% of mortgage debt to GDP

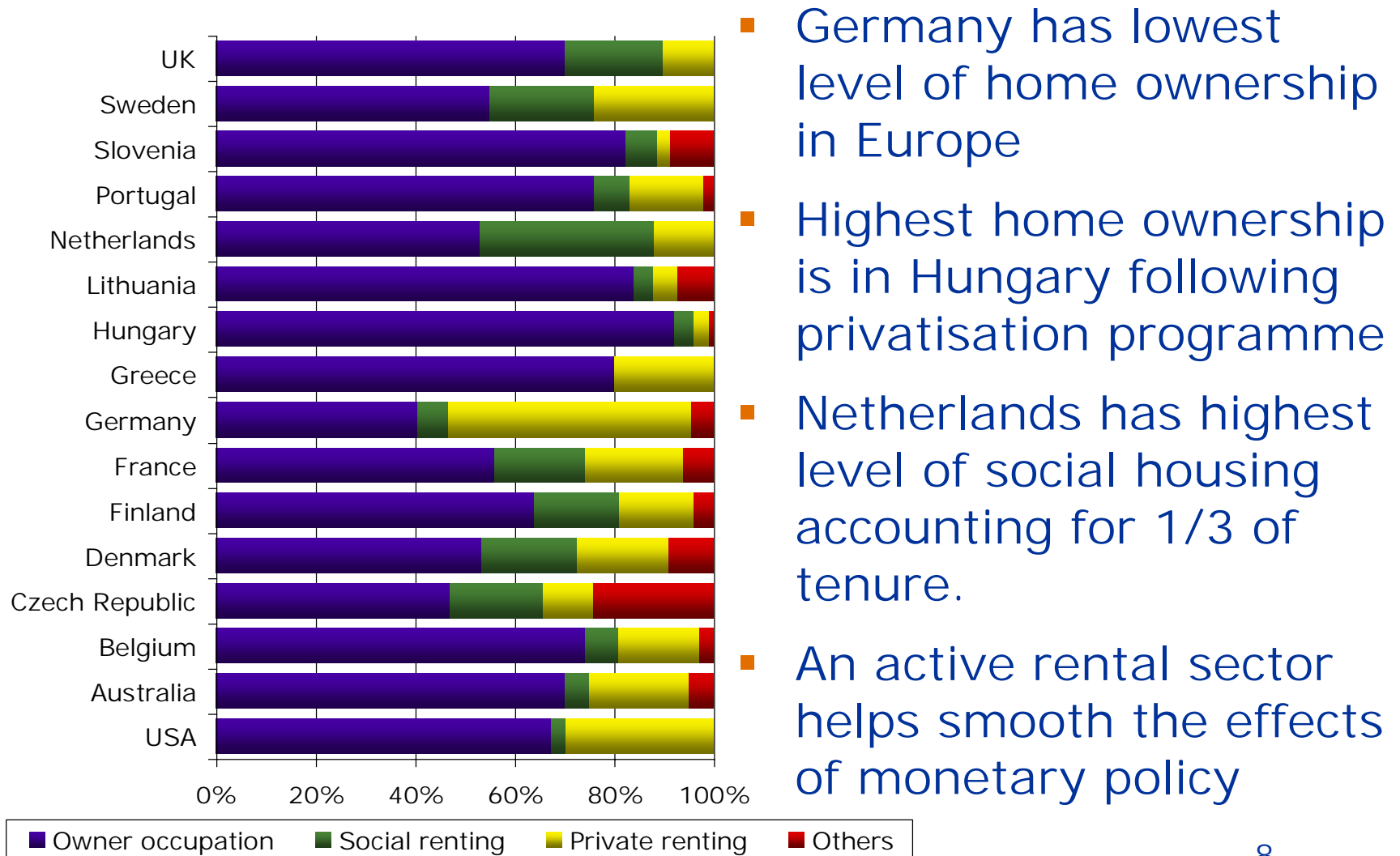
# Mortgage Debt per capita - 2003



- Clear North/South divide
- Largely historical and cultural, with greater use of debt in North and usury laws in South
- Position changing, southern markets growing rapidly compared to more mature northern markets

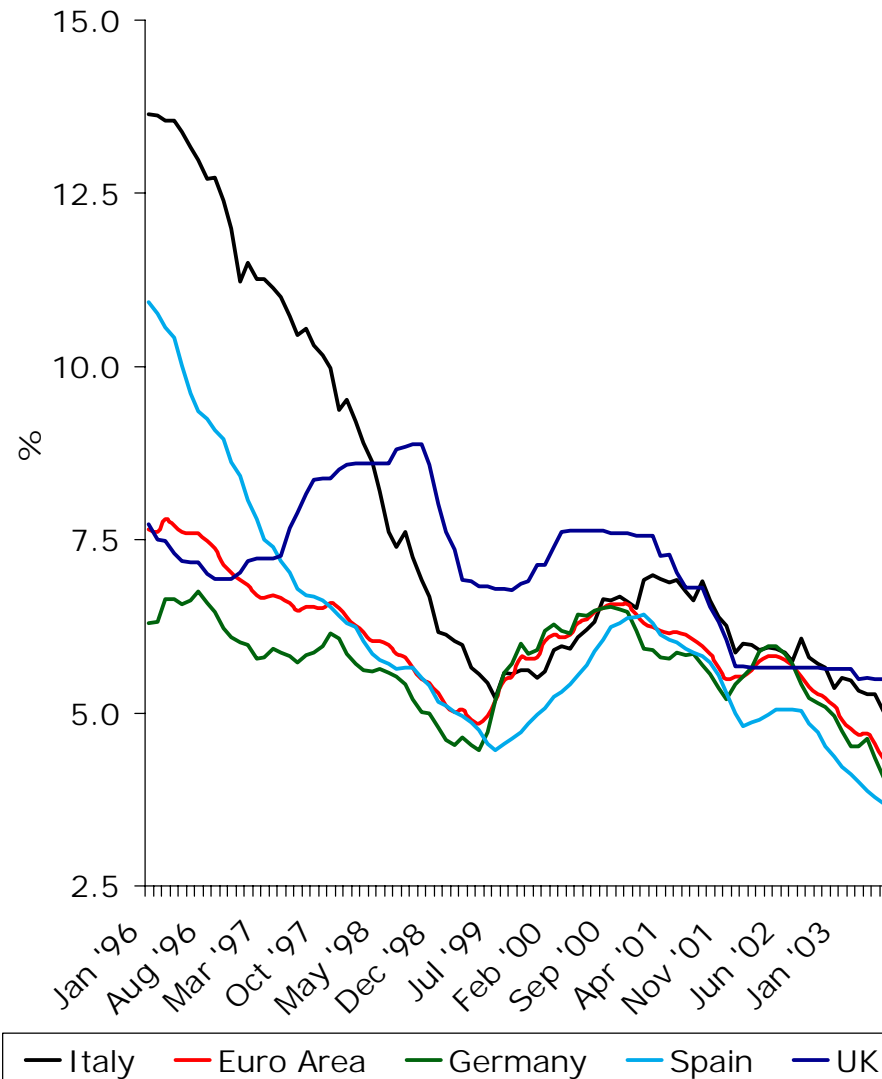
Source: European Mortgage Federation

# Housing Tenure in Europe- 2002



Source: European Mortgage Federation

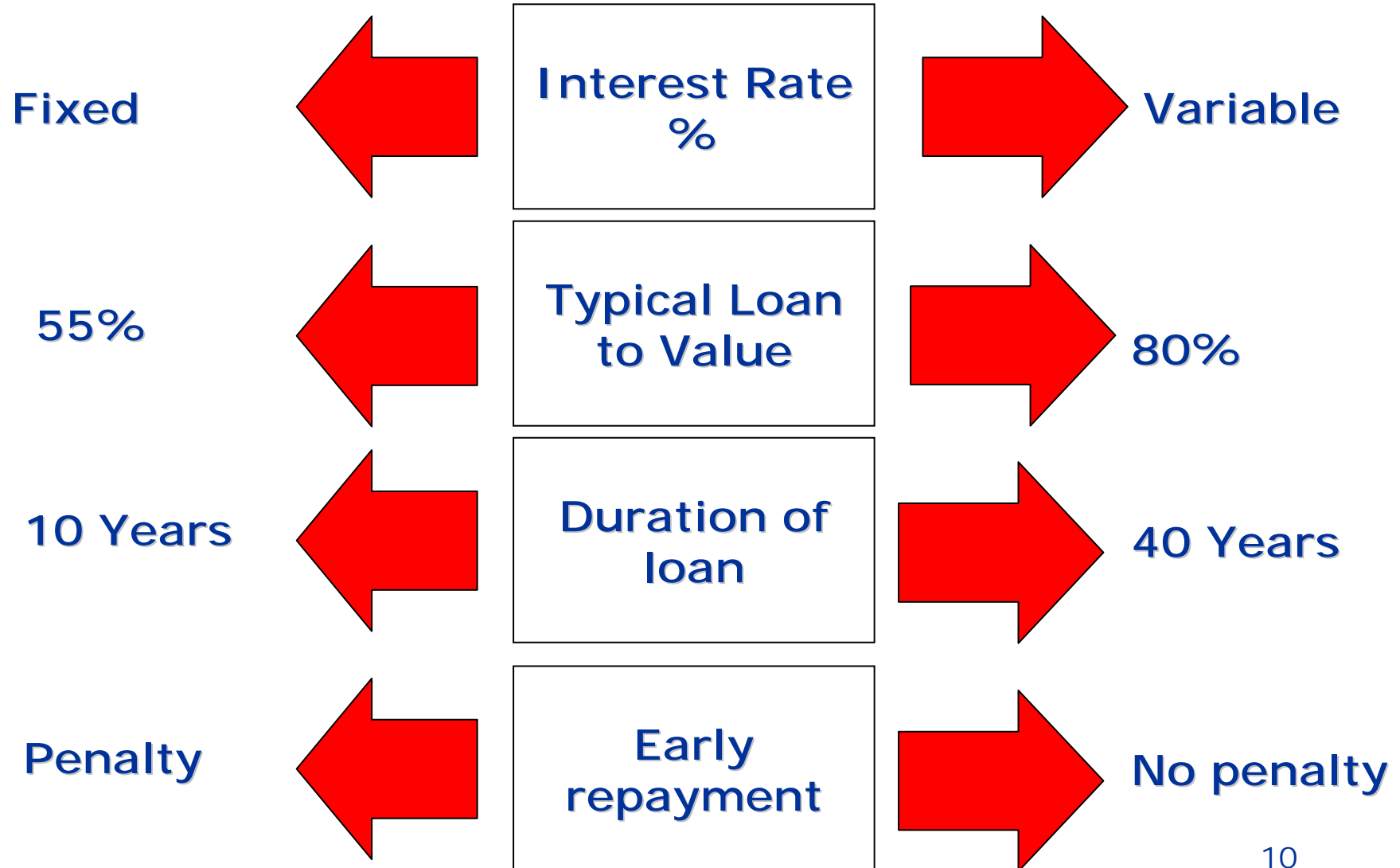
# Mortgage Rates



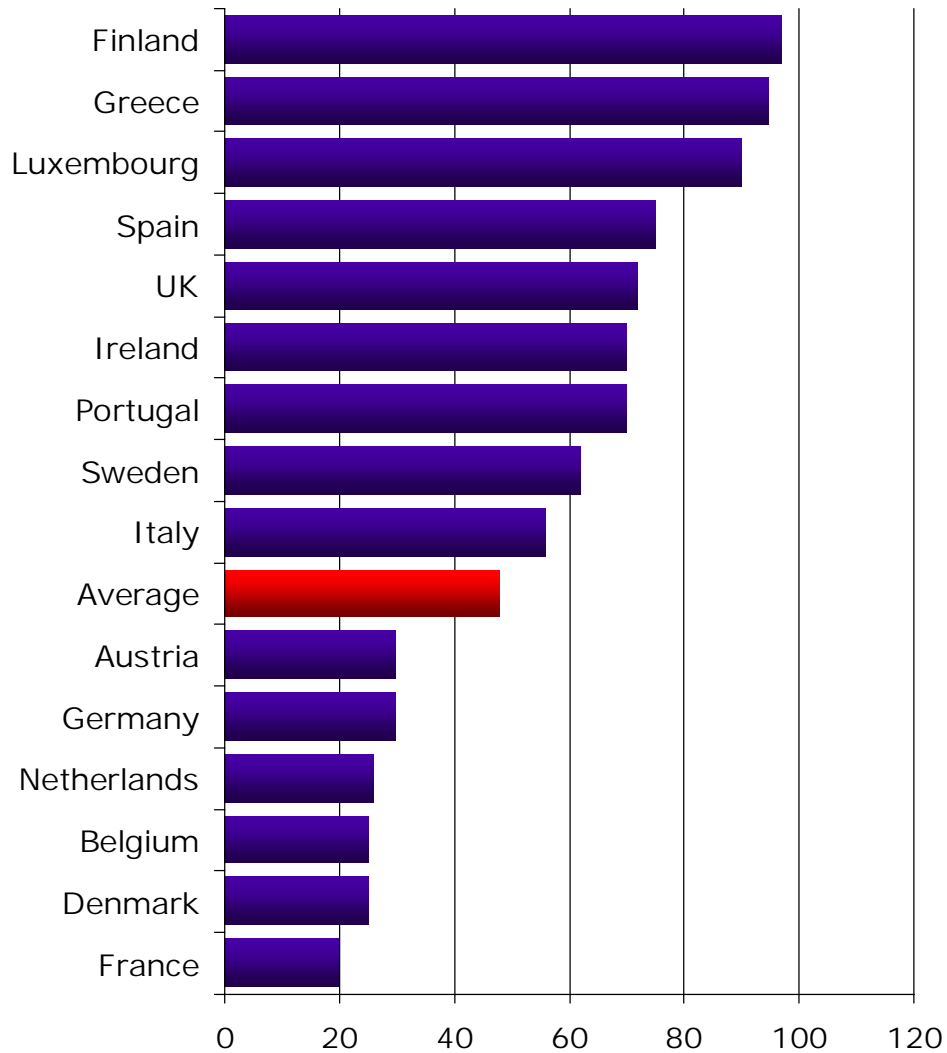
Source: European Central Bank

- Some convergence on mortgage rates, due to Euro and more integrated capital markets
- Remaining differences can be explained by funding costs, efficiency, competition

# Mortgage Products



# Variable vs Fixed rates - 2002



Source: European Mortgage Federation, ECB, Eurostat

- Large variances in interest rate variability
- Partly down to risk appetite of borrowers...
- Partly down to funding structures in place in individual countries
- Products available across the spectrum with many countries offering tracker products or capped which contain some variability.

# Risks / Vulnerabilities

- **House Prices**
  - Above trend at present in many countries
  
- **Over-indebtedness**
  - Rapid growth of secured and unsecured consumer credit
  
- **Growth of variable rate lending**
  - Improves transmission mechanism, potentially making monetary policy more sensitive
  
- **Over-regulation**
  - Capital Adequacy rules and integration measures could lead to much more regulation which would affect the range and price of products offered

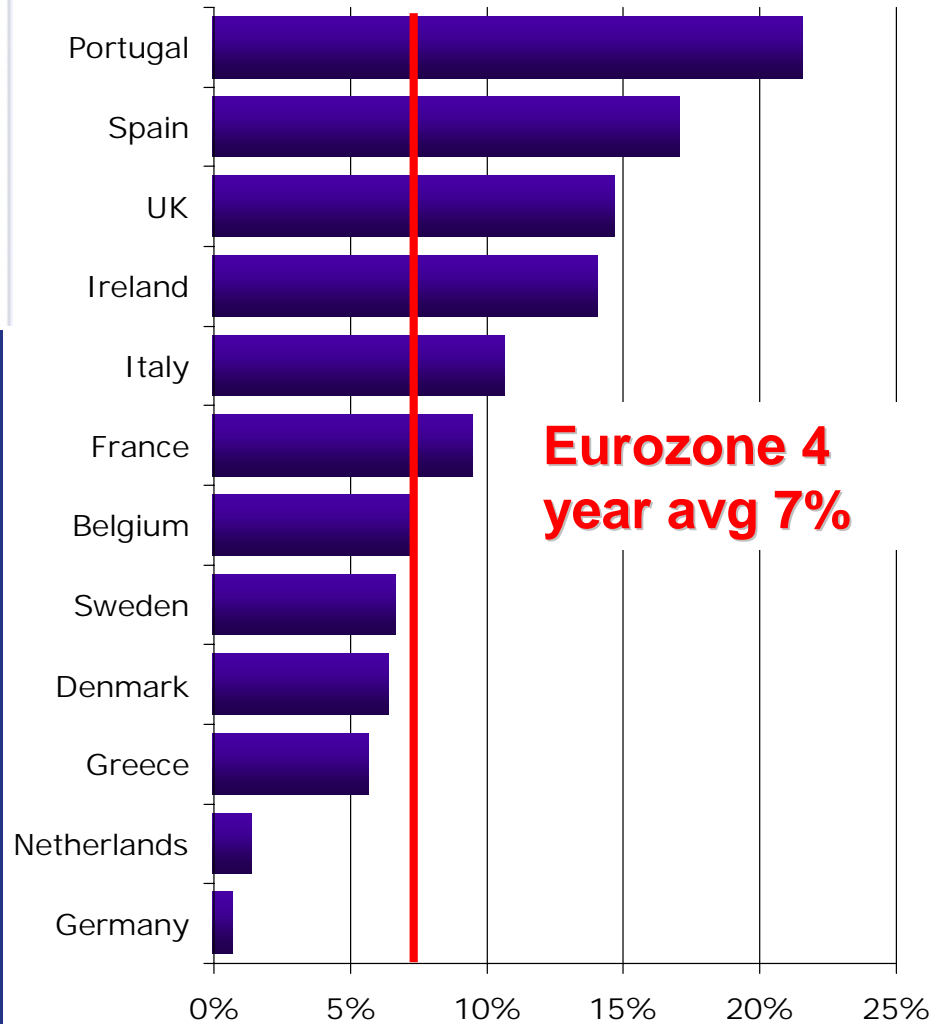
# Risks / Vulnerabilities

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...but industry is aware of risks

- **Risk Management**
  - Risk management techniques have improved dramatically over past 10 years
  - Economic capital models will be more in line with regulatory capital post Basel II
  - 'Safe' ceiling on debt has increased
  - Europe still substantially less indebted than US<sup>13</sup>

# House Price Growth 2003



Source: European Mortgage Federation

- OECD has warned about house price 'bubbles' in UK, Ireland and Spain
- French prices have grown rapidly in 2004, approaching 15% growth
- German market continues to stagnate, especially in East
- Urban/rural split remains in many countries

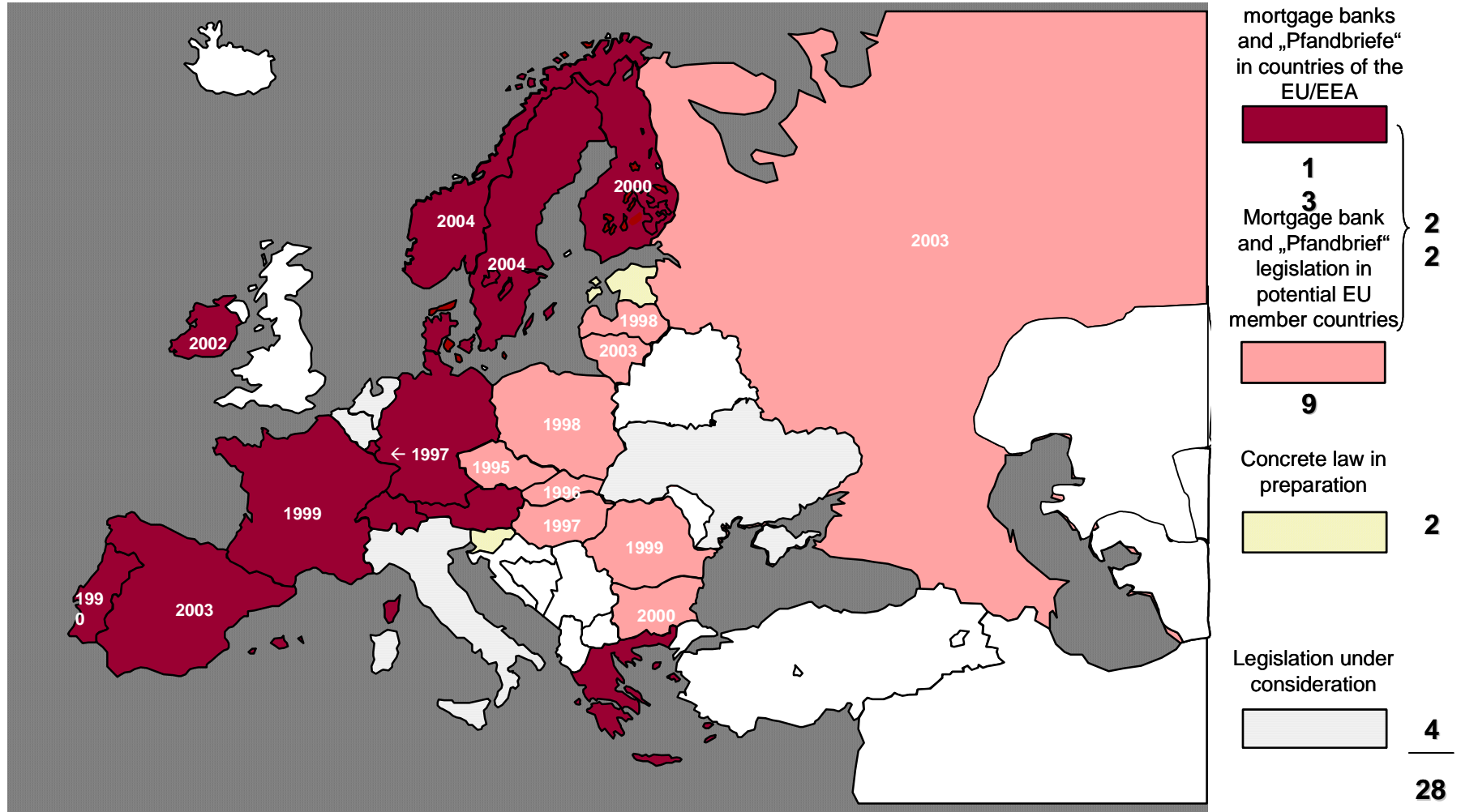
# Existing Funding methods

- **Deposits**
  - Suitable for flexible products
  - Low cost funding, but deposit base under pressure in Most European countries
- **Covered/Mortgage bonds**
  - Suitable for commoditised products (prime borrowers)
  - Prerequisite for long-term fixed rate loans
  - Relatively inflexible compared to loan products
- **Capital market funding**
- **MBS**
  - Most suitable for standardised products
  - Relatively expensive funding
  - Removes loans/credit risk from originator's balance sheet

# Covered Bond Market in Europe

- Outstanding volume of covered bonds in 2003 exceeded EUR 1.5 trillion (17% of EU bond market) – increase expected for 2005
- Covered bond market in Europe is highly concentrated
- Main markets: Germany, Denmark, Spain
- Recent mortgage bond legislation: France, Ireland, Norway, Sweden, Spain

# Geographical expansion



# Regulation of mortgage credit

## ■ Financial Services Action Plan

- Mortgages see as key to 'unleashing dynamism of Europe's financial markets'
- Should focus on implementing existing regulations properly first (taxes, competition, etc)

## ■ Forum group on Mortgage Credit

- 48 Recommendations covering all aspects of mortgage credit (consumer confidence, legal issues, mortgage collateral, distribution and funding)
- Awaiting cost/benefit analysis and green paper on Commission's policy options
- Consumer Protection is key are of discussion

## ■ Capital Requirements Directive

- Good for mortgage sector, but still many implementation issues.
- Tough timetable for some countries

# Mercer Oliver Wyman Study

1. To propose a definition and set of empirical indicators to examine and to describe the level of completeness and efficiency of selected national mortgage markets in the EU
  - Denmark, France, Germany, Italy, Netherlands, Portugal, Spain, UK
2. To examine to what extent price differentials are due to product differences, and thus value provided to the consumer, or differences in national supply conditions
3. To examine the potential efficiency and completeness benefits available via domestic change and via integration of mortgage markets and barriers to achieving them

## Mercer Oliver Wyman Study (2)

- Law of one price shows that markets are working efficiently and are already partially integrated
- At present economic rationale for cross-border does not exist, barriers make it too expensive
- Product cross-subsidisation make some markets difficult to enter
- Benefits available to lenders and consumers especially via integrated secondary market, but also more complete markets and improved efficiency.
- Integration more likely to occur via M&A and secondary markets, than via pure cross-border

# Challenges

- **Scale and Process Efficiency:** there are many relatively small markets, hence Europe lacks scale
- **Completeness:** product range still limited in some member states
- **Technology:** need to upgrade to meet demand, integrate lending and funding systems
- **Funding:** need to improve the link between capital market and mortgage markets
- **Europe:** consumers could reap benefits from further integration of markets.

# Lessons to be learned: there is no 'one size fits all' policy!



## 6 Key Fundamentals for an efficient, integrated Housing Finance System

- Affordability is linked to sound macro-economic policies: low interest rates are always more efficient than costly subsidies
- Keep transaction costs low and make mortgage collateral flexible
- Focus on efficient and transparent primary markets are crucially important
- Consumer Protection is important to build trust
- Look at standardising funding instruments to create liquidity and help tap capital markets
- Foster and educate investor base

# More Information ...



- Web: [www.hypo.org](http://www.hypo.org)
- E-mail: [swalley@hypo.org](mailto:swalley@hypo.org)
- Tel: +32 2 285 40 46
- Address: Avenue de la Joyeuse Entrée, 14/2  
Brussels 1040  
Belgium

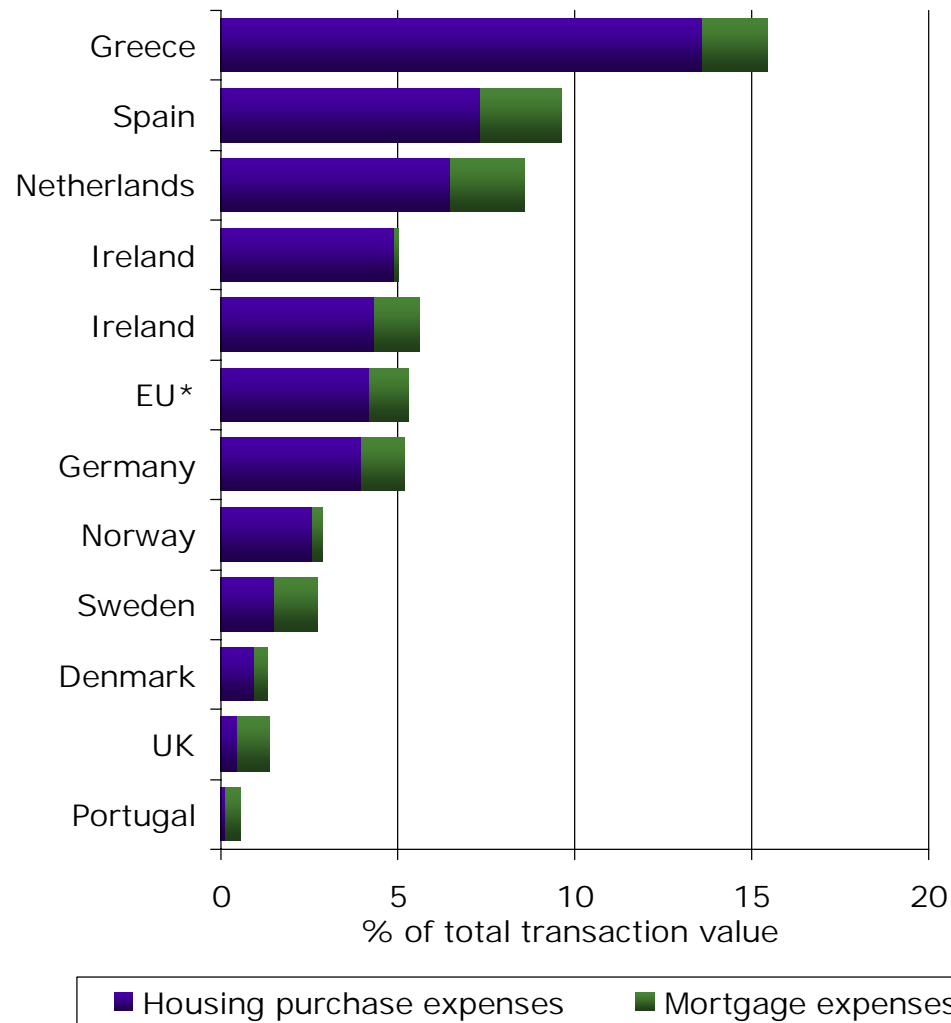


# Mortgage Products

Country	Length of contract	Typical LTV	% variable rate loans	Home owners with a mortgage
Sweden	30-40 years	80-90%	62%	-
Netherlands	30 years	87%	26%	85%
Denmark	30 years	Max 80%	25%	-
Portugal	25-30 years	90%	70%	Most
UK	25 years	70%	72%	60%
Austria	25 years	60%	30%	-
Germany	20-30 years	70-80%	30%	-
Belgium	20 years	80-85%	25%	56%
Finland	15-20 years	75-80%	97%	42%
France	15-20 years	Max 60%	20%	38%
Greece	15 Years	55%	95%	25%

Source: European Mortgage Federation, ECB, Eurostat

# Transaction costs - 2002



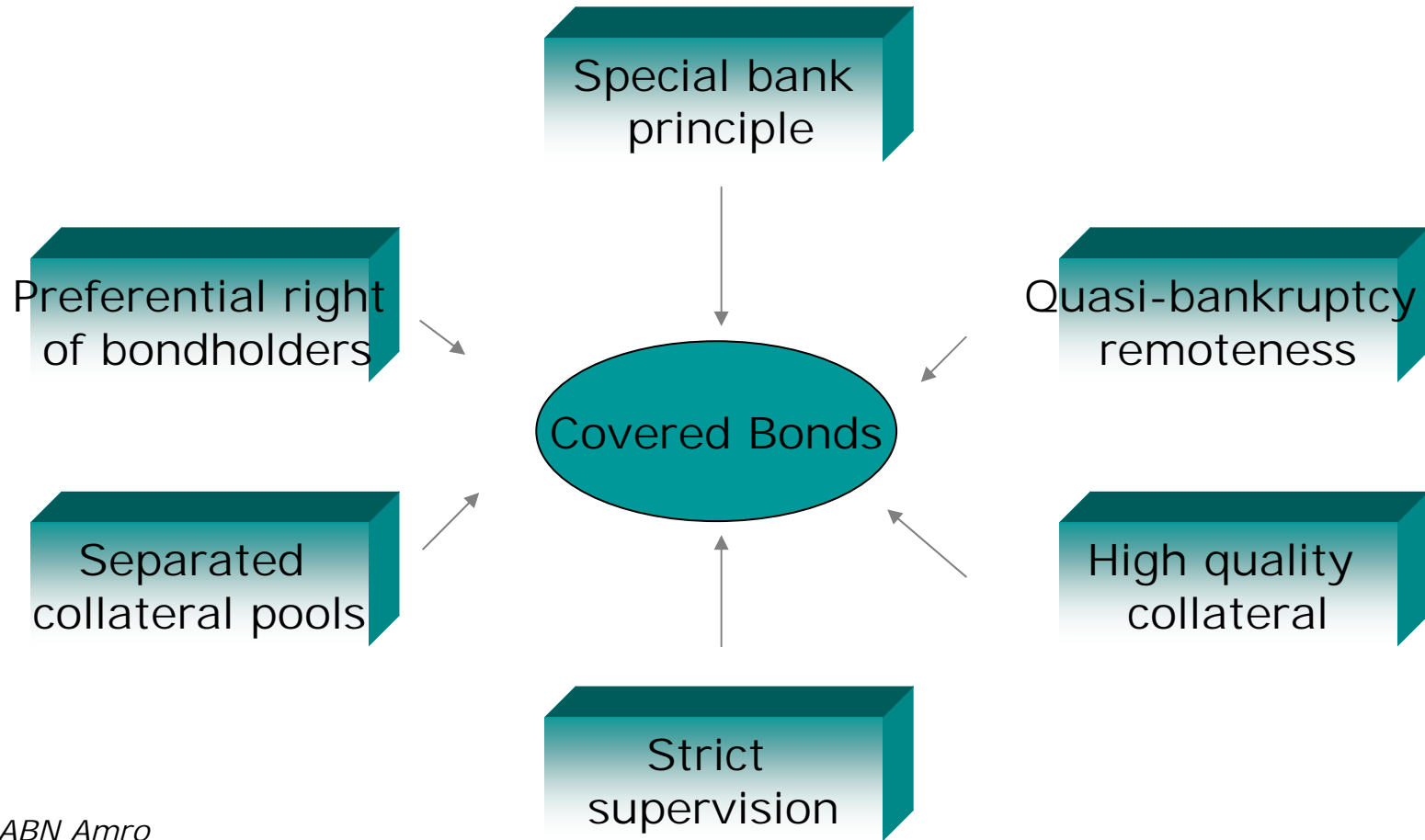
- On average in EU around 5% of the total value of a property purchase goes in transaction costs

- Costs include property registration, valuation, mortgage fees, loan taxes, administration costs, etc

- Further expenses can be added on in the form of property taxes (eg stamp duty)

Source: European Mortgage Federation

# A European Instrument



Source: ABN Amro