

# HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance



- ➔ The state of housing the housing market in New Zealand – trends, policies tried to date and their effectiveness
- ➔ On a subtle balance between micro- and macro- economics: Perspectives in the South Korean housing finance market
- ➔ Government's role in housing: The case of Singapore
- ➔ The global urban housing crisis and private rental in the Anglophone world: future-proofing a critical sector and tenure
- ➔ Security rights over immovable property: An international comparison of legal provisions at a glance
- ➔ Book Review: Milestones in European Finance



# International Union for Housing Finance

## Housing Finance International

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#### → Secretary General:

MARK WEINRICH  
E-mail: [weinrich@housingfinance.org](mailto:weinrich@housingfinance.org)

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MARK WEINRICH

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ANDREW HEYWOOD

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For further details, please contact Mark Weinrich  
([weinrich@housingfinance.org](mailto:weinrich@housingfinance.org))

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### International Union for Housing Finance

Rue Jacques de Lalaing 28, B 1040-Brussels - Belgium

Tel: +32 2 231 03 71

Fax: +32 2 230 82 45

[www.housingfinance.org](http://www.housingfinance.org)

Secretary General: Mark Weinrich

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# “BREXIT means BREXIT” ...but what does BREXIT mean?

On the 23<sup>rd</sup> June something that many believed to be unthinkable happened. In the referendum that had preoccupied the UK and much of the financially literate world for months, the electorate voted to sever the country's 43-year membership of the EU. The vote represents a major reversal of popular sentiment. In the 1975 referendum on membership 67% of voters chose to remain in the EEC. In 2016, 52% voted to leave on a significantly higher turnout. While the vote has shocked many in Europe and across the world, with hindsight one can see it as the culmination of a change in sentiment that has developed over decades. In 1975, UK Home Secretary Roy Jenkins (later to be an EU Commissioner) commented on the result:

*“It puts the uncertainty behind us. It commits Britain to Europe; it commits us to playing an active, constructive and enthusiastic role in it.”*

The notion of Britain “playing an active and constructive role” in Europe will probably raise a bitter laugh amongst EU politicians and officials but that is precisely the point. Over time, support for membership has eroded to the point where the “remain” campaign in 2016 chose to focus largely on what its opponents characterised as “project fear”: a message that essentially stated that the EU was gravely flawed but that the consequences of leaving would be even worse (much worse) than those of staying in and gritting our teeth. This was hardly a message to inspire and it didn't.

Those who regret the vote and are tempted to suggest that it can simply be set aside should reflect. At 72%, the turnout in the referendum was significantly higher than in the 2015 general election that elected David Cameron as Prime Minister. Further, while the vote was close, the leave side received a higher percentage of the popular vote than any UK government has received since 1945. The referendum result can be regretted but it cannot be ignored.

What is particularly disturbing about the current post-referendum position is that there is real dissension and uncertainty about what BREXIT means in practice amongst senior UK politicians and officials. Following recent announcements it appears that the Government will trade access to the single market for stronger control over EU inward migration thus making “hard BREXIT” a reality, but broader questions about the future shape of UK trade, the economy and relationships with Europe, the US, China and the rest of the

world remain unanswered. Reports of cabinet discussions suggest that ministers are divided. We now know that Theresa May intends to trigger Article 50 to start the exit process by March 2017 but beyond that the future remains opaque.

If the UK Government doesn't know what BREXIT means one can hardly expect commentators across the globe to have more clarity. Given the UK's status as the world's fifth largest economy and therefore its capacity to influence global growth and stability, that is not reassuring. The Bank of England has identified a range of economic risk factors that BREXIT could exacerbate, including a deteriorating current account deficit, an overheating commercial property market, high levels of household indebtedness, a risk that buy-to-let investors will exit a falling housing market, subdued global growth and financial market fragilities.

In terms of housing finance, the picture is uncertain also. However, there are concerns centred on the risks posed by a weaker and more volatile pound, and slower growth. In spite of a cut in interest rates by the Bank of England it is not clear how long low interest rates can prevail in this changed environment. Although the London Stock Exchange has seen share prices rise, shares in residential developers have fallen significantly and it is likely that they will be cautious in terms of building new homes at a time when some are suggesting that UK house prices may have peaked. Privately, mortgage lenders indicate that BREXIT is likely to make them more cautious about the future. Affordable housing providers are suggesting that the Government's plans to expand development within this sub-sector may be unrealistic. BREXIT raises other uncertainties also. How quickly will the construction industry be able to train new workers if reduced migration cuts the supply of skilled workers from eastern Europe? Will reduced inward migration affect demand for homes and even the balance of housing tenures? Recent migrants tend to rent rather than buy.

So what does BREXIT mean? One suspects that this question is not going to go away any time soon.

Ironically, this issue of HFI has a strong focus on the Asia-Pacific region, where governments are working to tackle private housing market pressures and where uncertainty about the future is

at least tempered by some consensus about the issues and by a degree of optimism. In addition to an excellent roundup of recent developments across the region compiled as always by Zaigham Rizvi, we have three new country-specific articles.

The New Zealand housing market has been overheating and the government has adopted a number of measures to tackle the problem. We are pleased to welcome back Shamubeel Eaqub to provide a robust analysis of the measures taken and their effectiveness. Mr Eaqub concludes that overall, the Government has failed to grapple effectively with the challenges identified, including rapidly rising house prices, high levels of investor activity and a long-term failure to build sufficient affordable housing.

South Korea is rarely featured in HFI and we are therefore pleased to present an article by Seung Dong You, a very experienced adviser and commentator on housing finance from that country. His valuable article provides a clear overview of recent developments in the South Korean housing and mortgage markets and an insightful analysis of risks to the housing finance market from both a macroeconomic and microeconomic perspectives.

In a fascinating article, Shi Ming Yu and Tien Foo Sing, examine the housing market in Singapore, focussing primarily on the public housing developed over many years by the Housing Development board [HDB]. HDB homes have helped keep housing affordable in Singapore and currently house over 80% of all households.

Returning to Europe, Steffen Wetzstein turns his attention to the private rented sector in an important article which examines the role and performance of private renting in the Anglophone countries with a strong focus on the UK. Wetzstein then goes on to analyse what needs to happen if the private rented sector is to adequately meet the needs of an increasing proportion of households in the future.

Our final article by Andreas Luckow, highlights some interesting and valuable work undertaken on comparative security rights over real property across Europe. The work was undertaken by an expert committee under the auspices of the Association of German Pfandbrief Banks [vdp] and the full results are available from them.

All in all, in these uncertain times one could do worse than spend a few hours studying this latest issue of HFI.

# Contributors' biographies

**Shamubeel Equb** is an independent economist. He has experience in commercial banks, investment banks, and economic consultancy. He has published numerous papers and books on economic issues of significance to New Zealand. The latest is "Generation Rent: Rethinking New Zealand's Priorities", co-authored with wife Selena Equb. His focus is on public policy issues that cross over with macroeconomics. He can be reached at [Shamubeel@equb.com](mailto:Shamubeel@equb.com) and his profile is available at [linkedin.com/in/equb](https://www.linkedin.com/in/equb)

**Andreas Luckow** is deputy head for cover assets for the Association of German Pfandbrief Banks in Berlin (vdp) since 2002. He specialises in cover assets in international real estate finance. His responsibilities include monitoring legislation, administration, supervision and markets in countries eligible for the Pfandbrief cover pools, development of positions and representation of the industry in respect of administration and markets, legal research and consultancy, mainly in the fields of real estate law, covered bonds and civil law. He is a trained lawyer and solicitor.

**Alex J. Pollock** is a distinguished senior fellow at the R Street Institute in Washington DC. He was president and CEO of the Federal Home Loan Bank of Chicago 1991-2004, and president of the International Union for Housing Finance 1999-2001.

**Zaigham M. Rizvi** is currently serving as Secretary General of the Asia-Pacific Union of Housing Finance and is an expert consultant on housing and housing finance to international agencies including the World Bank/IFC. He is a career development finance banker with extensive experience in the field of housing and

housing finance spread over more than 25 countries in Africa, the Middle-East, South-Asia, East-Asia and the Pacific. He has a passion for low-cost affordable housing for economically weaker sections of society, with a regional focus on Asia-Pacific and MENA.

EMAIL: [zaigham2r@yahoo.com](mailto:zaigham2r@yahoo.com)

**Kecia Rust** is the Executive Director of the Centre for Affordable Housing Finance in Africa, and manages the Secretariat of the African Union for Housing Finance. She is a housing policy specialist and is particularly interested in access to housing finance and the functioning of affordable property markets. Kecia holds a Masters of Management degree (1998), earned from the Graduate School of Public and Development Management, University of the Witwatersrand. She lives in Johannesburg, South Africa.

**T.F. Sing** is a Deputy Head of the Department of Real Estate, National University of Singapore (NUS). He is currently the Dean's Chair Associate Professor and serves as the Deputy Director at the Institute of Real Estate Studies, NUS. He is currently a member of the panel of assessors for the Appeal Board for Land Acquisition.

**Mark Weinrich** holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the General Secretary of the International Union for Housing Finance and the manager for international public affairs at the Association of Private German Bausparkassen.

**Dr Steffen Wetzstein** is a Human Geographer and Political Economist with research and teaching interests in urban development and

economic governance. After professional and academic roles in Munich, Auckland, Wellington and Perth, he is currently researching international 'Metropolitan Housing Affordability' issues at the Brandt School of Public Policy in Erfurt.

**Peter Williams** is Executive Director of the Intermediary Mortgage Lenders Association and a Departmental Fellow, Department of Land Economy, University of Cambridge. He was previously Director of the Cambridge Centre for Housing and Planning Research, Deputy Director General of the Council of Mortgage Lenders and Professor of Housing at the University of Wales, Cardiff. He is currently on the board of The National Housing Federation.

**Seung Dong You** is an assistant professor in the Department of Economics and Finance at Sangmyung University. Pursuing a career in real estate finance, he worked for the Korea Housing Finance Corporation, the Korea Mortgage Corporation, and the Korea Research Institute for Human Settlements. His book, "Housing Finance Mechanisms in the Republic of Korea", was published by United Nations Habitat and he has also published several papers on housing and housing finance markets. He frequently advises ministries, regulatory and legislative bodies, and corporations.

HOME PAGE: [www.peteryou.co.kr](http://www.peteryou.co.kr)

EMAIL: [peter.you@live.com](mailto:peter.you@live.com) or [peteryou@smu.ac.kr](mailto:peteryou@smu.ac.kr)

**S. M. Yu** is with the Department of Real Estate, National University of Singapore and was the Head of the Department from 2007-2013. He was also a former board member of the Housing and Development Board. He currently sits on the Council for Estate Agencies.



# Housing finance news from Africa: housing and Africa's growth agenda

↪ By Kecia Rust

Affordable housing delivery to meet an ever increasing demand presents a tremendous investment opportunity that can have a substantial impact on Africa's growth agenda. The construction, management, and occupation of housing are labour-intensive activities with substantial job creation potential, and which stimulate demand for goods and services across the primary, secondary and tertiary sectors of the economy. Calculating these backwards and forwards linkages, in Nigeria alone, a backlog of an estimated 17 million units suggests a housing investment opportunity of US\$28 billion.

The role of housing in Africa's growth agenda formed the theme of the African Union for Housing Finance's 32<sup>nd</sup> annual conference and AGM, held in September 2016 in Abuja, Nigeria. Co-hosted by the Nigeria Mortgage Refinance Corporation, the conference attracted 184 delegates from across the globe. The meeting had a very impressive agenda, and delegates were graced with the participation of royalty, Ministers, State Governors and other government officials, not to mention very senior and high profile members of the private, Development Finance Institution [DFI] and NGO sectors, all of whom are committed to the development of Africa's housing sector. An exhibition showcasing Nigeria's affordable housing sector, a Housing Investment Marketplace supported by Making Finance Work 4 Africa, a Housing Microfinance Academy hosted by Lafarge Holcim and a site visit to the housing delivered by Nigerian developer Urban Shelter also formed part of the proceedings.

Over the course of the three days, delegates acknowledged the enormous opportunity that housing presents for the growth of their economies. A presentation by David Gardner on work undertaken for the Centre for Affordable Housing Finance in Africa noted that in South Africa alone, the residential construction and rental sector involved R155-bn (\$11-bn) per annum in direct outputs or sales, and intermediate inputs, comprising 2% of total sales in the economy and 2.4% of total Gross Value Added. This made the Housing sector on par

with the Agriculture, Forestry & Fishing; Food; and Energy sectors. He noted that housing had significant impacts on secondary (manufacturing) and tertiary (services) sectors in four Standard Industrial Classification [SIC] sectors, and that it influenced four others. In terms of job creation, the housing sector in South Africa provides sustained, full time annual employment for 468,000 people. He urged delegates to consider how this data might be collected and analysed in their countries so that the full economic impacts of housing could be realised and supported.

Nigeria's Central Bank Governor, Mr Godwin Emiefele, argued similarly that investment in Nigeria's housing sector could mitigate the effects of the recession. Currently, the CBN estimated that the residential construction sector contributed one percent to the country's Gross Domestic Product. He compared Nigeria's housing construction sector with that of the United States and argued that the potential for growth was significant. He also acknowledged the critical role that policy makers could play – and in his field, making available long term loan capital to support the growth of a mortgage industry. A further constraint to Nigeria's housing development sector was the high cost of procuring raw building materials. Presenting work commissioned by the Centre for Affordable Housing Finance in Africa, Olivia Caldwell confirmed this. Her study compared the cost of delivering the same spec, 55m<sup>2</sup> house on a 120m<sup>2</sup> plot of land in sixteen different countries and found that what cost about US\$30 000 in South Africa, cost about \$43 000 in Nigeria and about \$67 000 in Uganda. A key feature in the Nigerian case was the cost of construction itself, comprising about 51% of the total cost. However, other factors, notably land, infrastructure and development services also have a significant impact.

A key feature deliberated upon was the potential for public private partnerships [PPPs] to enable the scale and efficient delivery of affordable housing. As part of a panel discussion on the topic, Femi Adewole of Shelter Afrique argued that PPPs needed to be well structured,

with each player taking a role appropriate to its own capacity. The role of government is to set an appropriate and enabling legal and regulatory framework, and to lead in the provision of serviced land for housing. Government can also provide legislative innovation and budgetary support for specific development objectives in the housing sector, such as VAT relief on newly constructed units sold to target market households. Full subsidisation is not required, however, as financial institutions have the capacity and appetite to provide development capital, risk mitigation products and end user finance. DFIs can provide additional capital, technical assistance and targeted risk sharing mechanisms. With the legal and financial framework in hand, developers can then drive the initiative with their development expertise, also taking part of the risk. Lastly, households themselves, have a variety of capacities to contribute towards the realisation of their housing needs – whether financially or with their labour. Public private partnership arrangements are risk-sharing arrangements in which parties bring together their resources and use these collectively to realise the objectives of the project and effectively manage its risks.

Of course, the key gap highlighted by all presentations was the lack of data available to support focused decision making. This is something that the International Finance Corporation's [IFC] Housing Finance Specialist for Africa, Habib Hann, spent quite a lot of time on in his presentation. He argued for the need for more detailed housing supply analyses (current housing production modes, current housing volumes, cost structure, construction material partners, market situation), housing demand analyses (affordability for housing and for which types of finance, informal construction market including production modes and volumes, cost structure, market situation), and data on the legal environment and financing capacities. These are all the issues that the Centre for Affordable Housing Finance is focusing on, and as part of the conference, CAHF launched the 2016 edition of its Housing Finance Yearbook, setting out the housing finance situation in now 51 African countries.

Following the conference, the AUHF held its AGM, welcoming new members and bringing the full membership complement to 55 from 16 countries. This is the first time that the AUHF has ever had so many members, and the numbers are growing every year. Members confirmed the AUHF's four-part strategy – including networking and deal making, information and communication, training and capacity building, and lobbying and advocacy. Finally, the AUHF AGM deliberated on the “Abuja Declaration on Housing Finance”, which will be sent to member governments and to the UN Habitat III meeting in Quito, Ecuador, articulating the key role of housing in Africa's growth agenda.

On the 16<sup>th</sup> September 2016 the AUHF AGM elected a new Board of Directors. The current AUHF Board includes: Oscar Mgya, CEO Tanzania Mortgage Refinance Corporation; Charles Inyangete, CEO Nigeria Mortgage Refinance Company; Omar Sarr, CEO of the Home Finance Company of the Gambia; Ruth Odera, Regional Housing Microfinance Project Manager, Habitat for Humanity International; Joseph Chikolwa, Managing Director, Zambia National Building Society; Cas Coovadia, Managing Director, Banking Association South Africa; Reginald Motswaeso, CEO Botswana Housing Corporation; and Femi Adewole, Director Shelter Afrique.

To access the presentations given at the AUHF's 32<sup>nd</sup> annual conference, held from 14-16 September 2016 in Abuja, Nigeria, visit the AUHF's website: <http://www.auhf.co.za/conference/housing-and-africas-growth-agenda/>

To access CAHF's 2016 Housing Finance in Africa Yearbook, visit: <http://www.housingfinanceafrica.org/document/2016-housing-finance-in-africa-yearbook/>

# Asia Pacific Union for Housing Finance: News update August 2016

↪ By Zaigham M. Rizvi

## India

↪ Ms. Dimple Malde, HDFC-India

The housing shortage in India is immense. Most of the shortage is in the low-cost affordable housing segment. Because of the vast demand and government efforts, a large number of players have entered this segment. The mortgage to GDP ratio in India is at over 9% and remains significantly lower compared to its peers.

India is known as one of the fastest growing large economies in the world. A large consuming middle-class, rising disposable incomes and improved affordability are driving aspirations. One of the key desires of India's rising middle-class is to be a homeowner.

Several measures have been announced to support the housing industry, these include –

**Real estate regulator:** The much awaited Real Estate (Regulation & Development) Act, 2016 was enacted in May 2016. The Act aims to protect the interest of buyers by introducing a regulatory regime to improve transparency and accountability in the sector. The housing ministry has recently issued draft rules for the new Real Estate Regulatory Authority [RERA]. While the implementation of the Act at the state level may take time, in the long term, it will bring in the much needed efficiencies to the Indian real estate market.

**Higher fiscal incentives:** The government has incentivized the small home loan borrower by increasing fiscal incentives. The Union Budget 2016-17 provided an increased Rs. 50,000 tax deduction p.a. on the interest component of a home loan, provided the loan is less than Rs. 3.5 million and the value of the property is under Rs. 5 million. The total fiscal incentives on a home loan, through deduction of interest and principal, have been increased to Rs. 0.4 million. This measure encourages the first time homebuyers in the affordable housing segment.

**Incentivize developers:** To increase the supply of affordable housing, the government has provided a 100% deduction of profits from

affordable housing projects provided certain conditions are met. Also an exemption from service tax on construction under specified housing schemes is provided. These additional fiscal incentives to the developers catering to the affordable housing segment will go a long way in satiating housing demand in this segment.

Several **government schemes** such as Housing for All by 2022, Smart Cities Mission and Atal Mission for Rejuvenation and Urban Transformation, will help meet the housing shortage and improve urban infrastructure.

**Access to an alternative source of funding:** Mortgage finance players have been allowed to access international funding through external commercial borrowings for financing low cost affordable housing and through Rupee denominated overseas bonds. This will help lenders diversify their borrower base.

HDFC is the first Indian corporate to have issued a Rupee denominated overseas bond.

**Real estate investment trusts** may finally become a reality with the removal of the dividend distribution tax.

While the government has clearly recognized the benefits of encouraging a property owning democracy and has made efforts in this direction, implementation at the ground level will determine the success of these schemes.

## Thailand

↪ Mr. K.I.Woo, GHB-Thailand

### Bausparkassen seminar

The Government Housing Bank [GHB] has hosted a Bausparkassen seminar. On August 10, 2016, GH Bank and Germany's Association of Private Bausparkassen jointly hosted a very successful seminar "Bausparkassen: A Prospective Scheme Promoting Home Ownership in Thailand" in Bangkok.

About two hundred industry professionals attended the event.

GHB President Chatchai Sirilai welcomed the guests. Khun Wisudhi Srisuphan, Deputy Minister of Finance outlined government support for considering housing finance programs that are based on Bausparkassen's "savings-before- mortgage" loan principles.

Andreas Zehnder, Chairman of the German Association of Bausparkassen and President of the International Union of Housing Finance said that, currently, Germany has 22 Bausparkassen; ten public Bausparkassen operate within regionally defined markets while 12 private Bausparkassen conduct business nationwide. The Bausparkassen share of the housing finance market is 20% in Germany and the program has now been successfully introduced into many European countries including Austria, Croatia, Czech Republic, Hungary, Kazakhstan, Luxembourg, Romania and Slovakia. He said that the Bausparkassen approach has also been adopted in parts of China.

A critical Bausparkassen strategy is helping people develop financial plans and savings discipline. All borrowers must enter "Saving for the future loan" agreements. The amount saved relates to future loan amounts. Savers prepare for their future Bausparkassen loans by entering savings programs of five to seven years before being granted mortgages.

An understanding of the Bauspar System, Zehnder said may help Thai people develop new financial products that will enhance new housing loan innovations in the country and spur future housing industry development.

Christian Konig, the Bausparkassen association's legal advisor explained that prospective home buyers initially enter into three-phase Bauspar contracts with their savings institutions.

1. The Savings Phase defines the savings period and interest rates that the saver will receive during the savings period before a mortgage is provided for a new home purchase.
2. The contract allocation period defines the customers' contractually agreed savings



sum, the price of the home he wishes to purchase and the loan amount he will receive.

3. The loan phase defines the loan interest rate, the number of installments and the installment period.

Konig said Bausparkassen operate as ring-fenced closed-systems wherein the current savers fund those that receive mortgage loans. The savers receive small government subsidies for completing their savings contracts while borrowers received fixed rate long term loans.

It was observed that GHB would most likely be the best entity to adapt Bausparkassen housing principles to develop innovative new housing products for middle and lower income home buyers.

GHB has recently introduced the “GH Bank Financial Literacy” programme, which focuses on developing savings discipline so that more Thai families can own homes in the future. GH Bank may be able to adapt certain Bausparkassen concepts, because in addition to being advantageous for the Bank it creates awareness, understanding and financial discipline for people who would like to own their own homes. Moreover, it will be a great method to prepare newly graduate students and new job-seekers access to future housing loans.

### Thai residential property market rebounding

The Thai residential property market is expected to rebound substantially in the second half of 2016.

Thongma Vijitpongpan, CEO of Pruksa Real Estate told *The Nation* that although the property market in the second quarter fell by up to 10% compared with the same period last year, he was confident that the market will recover in the second half and will drive overall growth up to 10% [for the full year] or Bt330 billion (\$US10 billion) in Bangkok and suburban areas. Most property companies are launching special promotional campaigns to boost second half sales.

### Housing finance in Pakistan as on June 30, 2016

↳ Syed Wasif Hussain, SBP-Pakistan

During the current quarter, the overall outstanding housing finance portfolio stood at Rs. 65.70 Billion as of June 30, 2016; an increase of 4.35% over the quarter. The House Building Finance Company [HBFC] remained the largest stakeholder, in terms of gross balances outstanding, with a share of 24%. However, based on category, Islamic Banks remained the largest players with a 38% share in gross outstanding. Fresh

disbursement for the quarter accounted for Rs. 6.08 billion with 1,213 borrowers. Furthermore, non-performing loans increased to the level of Rs 12.75 billion compared to previous quarter's Rs 12.63 billion; a marginal increase of 0.95% during the quarter. The House Building Finance Corporation Ltd [HBFC], being the largest player in the housing finance market, accounted for 52.55% of new borrowers and contributed 18.05% of the new disbursements equivalent to Rs. 1.10 billion. Islamic banks disbursed Rs. 3.30 billion. The major portion of the total outstanding remained directed towards the “Outright Purchase” category as 65.52% of the gross outstanding was used to finance this category of housing loans. It was followed by “Construction” and “Renovation” products with 23.32 and 11.16% respectively.

During the quarter ending June 30, 2016, Islamic banks and HBFC remained active in extending housing finance. This rise in disbursements is a reflection of efforts to create an enabling environment for housing finance in Pakistan. This will be instrumental in increasing economic growth through positive changes in 40 industries allied to housing sector. Keeping in view overall trends, it shows that Housing finance in Pakistan is gradually growing.

### Khushhali Bank and IFC sign deal to develop housing finance

Khushhali Microfinance Bank and the International Finance Corporation [IFC] have signed an agreement under which IFC will help the bank to develop a housing finance product, targeting primarily the underserved and rural

communities of Pakistan. (<https://www.thenews.com.pk/print/128375-Khushhali-Bank-IFC-sign-deal-to-develop-housing-finance>)

### Government committed to conduct population, housing census: Ishaq Dar

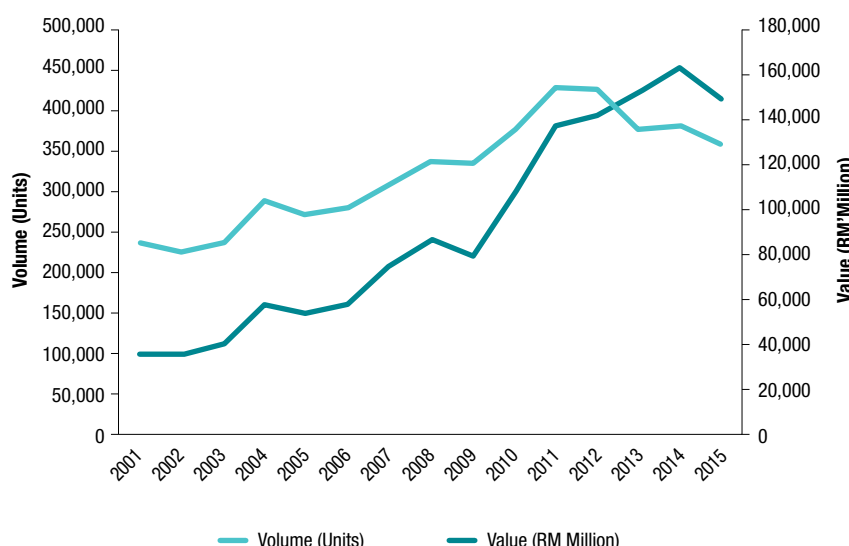
Minister for Finance Mr. Ishaq Dar said that the Government of Pakistan is dedicated to conducting a long-awaited population and housing census in the country as early as possible. Addressing a news conference in Islamabad, the Minister said that fourteen billion rupees would be spent on the census by the government, in addition to the funds provided by the United Nations Population Fund for said purpose. (<http://en.dailypakistan.com.pk/pakistan/govt-committed-to-conduct-population-housing-census-ishaq-dar/>)

### International Expo-2016

The International Expo-2016 was organized by the Association of Builders and Developers Pakistan [ABAD]. The Governor of Sindh Dr Ishratul Ebad Khan inaugurated the event and said that the construction industry is a vital force for economic development of the country as the construction sector plays an active role for bringing in development and societal changes.

He further said that organizing the international expo would be helpful in phenomenally accelerating construction activities in the Pakistan. He said it is a good omen that 17 delegations of prospective international investors have participated in Expo-2016 as it will enhance investment in the construction sector of the country.

Table 1.1 Volume and Value Property Transactions



## Malaysia

→ Chung Chee Leong, President/Chief Executive Officer, Cagamas Berhad

### Property market overview

The performance of the property market in Malaysia remains subdued with a challenging economic and financial environment facing the country during the past few months. While certain countries were still recovering from the effects of the last debt and economic crisis, the global economy has been hit again by concerns surrounding the impact of Brexit and the continued weakening economy of China. The development and investment climate in Malaysia has generally been affected to a certain degree by these developments. As at Q2 2016, the Malaysian economy had expanded by 4.0% (Q1 2016: 4.2%) supported mainly by domestic demand.

In 2015, there were 362,105 property market transactions (RM149.9 billion), down by a marginal 6.0% in volume and 8.0% in value against 2014 (Table 1.1). The residential sub-sector contributed the biggest share of the market, with a 65.2% contribution in volume and 49.0% in value.

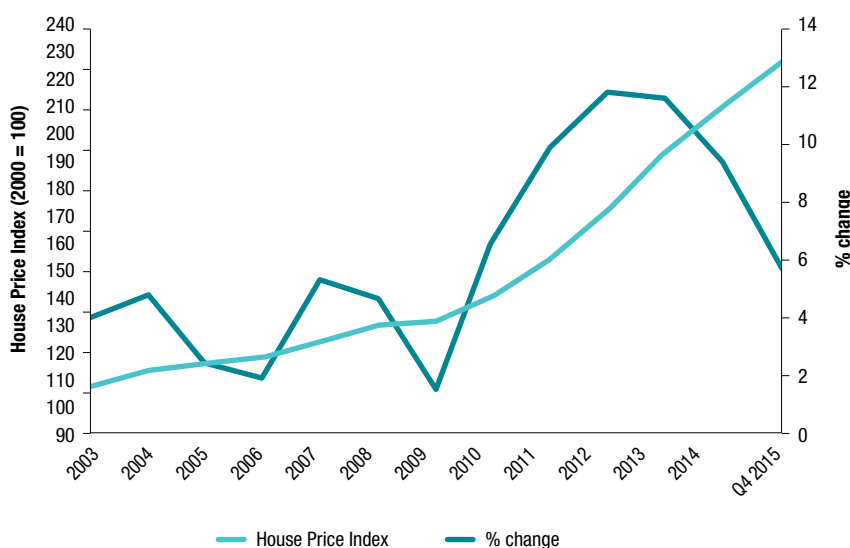
As of Q4 2015, the Malaysia House Price Index [MHPI] stood at 227.5 points (above the base year 2000), up by 5.8% on an annual basis (Table 1.2). The annual rate of increase for MHPI has been on a decelerating trend since Q4 2013, as a result of various cooling measures implemented by the Government and the Central Bank of Malaysia [BNM] to contain spiraling prices.

### Residential property

By the end of 2015, there were 235,967 residential property transactions worth RM73.47 billion recorded in the review period, a decline by 4.6% in volume and 10.5% in value against 2014. The primary market reacted accordingly as the number of new launches reduced to 70,273 units, down by 19.2% against 2014 (86,997 units). The overall sales performance of residential units in Malaysia hovered at 41.4% (29,089 units sold), lower than the 45.4% (39,491 units sold) achieved in 2014. There were 11,316 residential overhang<sup>1</sup> units worth RM5.9 billion, up by 16.3% in volume and 56.0% in value. On a similar trend, the unsold units under construction recorded an increase of 28.6% to 68,760 units due to large numbers of unsold condominium and service apartment units.

According to the latest preliminary report from the National Property Information Centre [NAPIC]

**Table 1.2 Growth of MHPI and % change**



**Table 1.3 Volume of transactions by price range for the residential property sub-sectors**

PRICE RANGE (RM)	Q1 2015	Q1 2016	GROWTH
400,000 – 500,000	3,534	3,726	5.4%
500,001 – 1,000,000	6,249	5,429	-13%
1,000,000 – above	2,430	1,841	-24%

as at Q1 2016, residential property market transaction value in Malaysia declined by 9.5% year-on-year to RM17.9 billion. The negative growth in transaction value is consistent with the 16.6% fall in volume to 49,612 units in the same period. Further analysis of the data shows that, market preference is skewed towards houses worth RM400,000 - RM500,000, in that the transaction volume of properties within this price range increased by 5.4% year on year compared with a 13% decline for properties worth RM500,000 – RM1.0 million and a 24% decline for properties worth RM1.0 million and above (Table 1.3). There is also a sign of recovery in property demand as data measured by “Applied Loan for Purchase of Property” published by BNM. As at May 2016, the data has shown an increase of 2% year on year to RM25.79 billion, an increase for the first time after 16 months.

The pre-emptive macro-prudential and fiscal measures implemented since 2010 by the Government and BNM aimed to mitigate potential risks to financial stability from strong growth in housing prices but has also helped improve

housing affordability, particularly for first-time buyers. The average growth in house prices as measured by MHPI has declined from 9.6% registered for the period of 2010-2014 to around 8% registered over five consecutive quarters since second quarter of 2014.

### Affordable housing

Elevated housing prices continue to reflect imbalances that have been characterized by an acute shortage in the supply of houses within the affordable segments (below RM250,000) and an increasing share of supply of more expensive homes (priced above RM500,000). As at Q3 2015, new launches of affordable houses priced below RM250,000 accounted for less than 30% of total launches in the year 2015.

Nevertheless, we have seen some encouraging developments where the volume and value of housing transactions in 2015 for houses for this segment recorded positive growth of 6% and 13% compared with 2014. Demographic factors such as Malaysia's relatively young labor force

<sup>1</sup> Unsold completed units (data excluded new property launches).

and increasing urbanization continue to be key drivers of demand for affordable housing. The Government has announced multiple plans to focus the construction of low-cost and affordable housing units in strategic locations which would increase the take-up rate of this segment. However, without a continued and significant increase in the private sector-driven supply of affordable housing, demand will be likely to continue to outstrip supply for the foreseeable future.

## Conclusion

Based on the reduction in the rate of property price increases as measured by the MHPI as explained above, property prices are expected to move to a more accommodating level in due time. It would help ease the pressure on buyers in obtaining financing for home purchases if prices of homes could level within affordable ranges. Furthermore, the BNM's recent decision to reduce the overnight policy rate [OPR] from 3.25% to 3.00% is expected to spur economic activity and stimulate domestic economic growth, particularly loan growth in the property

segment. Ultimately, market confidence needs to be restored in order to restore the property sector back to its condition before the present challenging period.

## Concluding note on the Asia-Pacific region and its institutions

↳ Zaigham M. Rizvi, Secretary General Asia-Pacific Union for Housing Finance [APUHF]

The Asia-Pacific region, on the one hand has multifarious challenges on affordable housing supply as well on the demand-side. The region offers success stories and best practice business models in different areas of housing and housing finance. The platform of the APUHF aims to facilitate sharing of information, knowledge, and best practice among countries of the region.

For example, the Government Housing Bank [GHB] of Thailand is a state-owned specialized housing finance institution, and offers a very successful business model of an effective, viable and sustainable state-owned housing finance

institution. The numbers denoting its operational performance speak for themselves.

Similarly, the Housing Development and Finance Corporation [HDFC], in India is a housing finance institution operating in the private sector. It is again a remarkable institution, offering a best-practice business model for many of us in the region to learn, share wisdom and operational models in different areas of housing finance. At HDFC again, the numbers speak for themselves.

Cagamas-Malaysia, the lead housing finance institution of Malaysia offers commendable best practice in the area of long term liquidity facility institutions and market based instruments for the same. Long term liquidity is becoming an impelling challenge for housing finance institutions of the region, since funding housing finance through state and state-owned entities is drying up.

The member institutions of APUHF are welcome to seek guidance on any of these areas from these member institutions of APUHF and many other regional housing finance and supply institutions.

# Europe: trends in house prices and construction

↪ By Mark Weinrich

The upswing in the European housing market which started after years in the doldrums in 2015 continued in 2016 and gained momentum. Across the Eurozone, house prices rose by 3.0% and by 4.0% across the European Union as a whole in the first quarter of 2016 compared with the same quarter of the previous year.<sup>1</sup>

However, the aggregate figures mask different trends at the country level. The highest annual increases in house prices in the first quarter of 2016 were recorded in Hungary (+15.2%), Sweden (12.5%), Austria (+13.4%), United Kingdom (+8.0%), Latvia and Ireland (both +7.4%). The United Kingdom and Latvia have newly joined the above list. This is particularly noteworthy in the case of Latvia as it was the country with the most negative price movement in the third quarter of 2015 (-7.8%). The smallest house price increases or largest decreases in the first quarter of 2016 were recorded in Cyprus (-1.2), Italy (-1.2), Croatia (+0.6), Finland and France (both +0.8).

Evidence suggests that the housing market in several countries may be reaching its peak in prices. Sweden for example has a notoriously hot housing market. Steady economic growth and low interest rates have propelled property prices for several years in a row, causing

warnings about a debt crisis and a housing bubble from top economists. As consequence, on June 1 new rules forcing Swedes to pay off mortgages were introduced. The rules require that loans for more than 50% of the value of the property will have to be amortized by one percent a year. For loans exceeding 70% of the value, the requirement is two percent a year. The new law caused house prices to drop in May compared to the previous month as sellers wanted to exit the market before the new rules were introduced, effectively increasing the supply of houses and apartments.

It is also important to note that the most crisis-hit nations, Ireland, Portugal and Spain, continue to be on the road of recovery with respect to the housing market, based on strengthening economic fundamentals.

Growth in total construction output for the 19 European countries who are members of the EUROCONSTRUCT-Network was 1.4% for 2015 and is expected to improve to 2.6% in 2016. The overall value of the construction industry itself is estimated to be €1.406 billion in 2016. This equates to 9.4% of GDP and is significantly lower than the peak of 2007, when the industry accounted for 13% of GDP. In addition, while in 2006 the share of new construction was signifi-

cantly higher than that of renovation measures (60% of total residential investment), during the past ten years this situation has been reversed with renovation measures now taking a share of 60%. However, the old peak values of the last decade for the economic importance of the construction sector in general and investment in new housing in particular should not serve as a target for the current recovery as they have to be seen as a symptom of excessive investment in real estate, notably in Southern Europe but also Ireland.

In several countries the current recovery in the construction sector is based on pent-up demand. Little was built and modernized in the crisis years so that excess demand is eventually materializing – with the most impressive example being Ireland. This backlog makes the current economic recovery almost a sure-fire success but it is quite certain that this demand effect will diminish in the medium term. Furthermore, as long as the economic upswing in Europe is based more on the very accommodative monetary policy of the European Central Bank and not on healthy market fundamentals, the more likely it is that construction demand will lose momentum at the end of the decade. Brexit, however, is unlikely to have dramatic effects on the European construction industry.

<sup>1</sup> All data on house prices are from Eurostat: [http://ec.europa.eu/eurostat/statistics-explained/index.php/File:House\\_Price\\_Index\\_-\\_Quarterly\\_and\\_annual\\_growth\\_rates-2016Q1.png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:House_Price_Index_-_Quarterly_and_annual_growth_rates-2016Q1.png)

# Home Ownership Rates: It Depends on Whether You Are Married<sup>1</sup>

↪ By Alex J. Pollock

American political rhetoric endlessly repeats that home ownership is part of the “American Dream.” So it is for most people, especially if you are married, as we will see.

As part of promoting this “dream”, the U.S. Government has for many years created large subsidies for mortgage borrowing and huge government-sponsored financial institutions to expand mortgage lending. Most notable among these are Fannie Mae and Freddie Mac, which notoriously went broke in 2008 while following the government’s orders to make more so-called “affordable” loans, and survived only thanks to a \$189 billion taxpayer bailout.

Fannie and Freddie are still massive operations, featuring a combined \$5 trillion in assets (that’s “trillion” with a T), equity capital that is basically zero, and utter dependence on the credit of the U.S. Treasury.

Given these massive and extremely expensive efforts, how has the American home ownership rate fared? Let us look back 30 years to 1985, and compare it to 2015. Thus we can go past the housing bubble and collapse of the 2000s, as well as past the financial collapse of the savings and loans in the late 1980s, and observe what has happened over a generation.

What we see is that on average for the United States, from 1985 to 2015, despite all the efforts to push it up, the home ownership rate fell:

## Overall U.S. home ownership rate

1985	2015
64.3%	63.5%

However, it turns out that the overall average is composed of two completely different parts.

For married households, the home ownership rate is a lot higher *and* it has gone up:

## U.S. married household home ownership rate

1985	2015
75.9%	78.2%

If you are married Americans, you have a very high and improved probability of owning your own home. It is easy to think of reasons why home ownership would be more achievable and more important to you if you are married than if you are not.

All other households, those which are not-married, have a much lower home ownership rate. This seems logical. It is striking, however, that the home ownership rate for this group has also gone up a lot since 1985:

## U.S. not-married household home ownership rate

1985	2015
36.0%	43.4%

So here’s a puzzle: married household home ownership went *up*, and not-married household home ownership went *up*. Combined that is all the households there are. But the overall home ownership rate went *down*. How is that possible and what does it mean?

It means that the *mix* of married versus not-married households changed dramatically. Married households, with their far higher home ownership rate, fell remarkably as a percentage of all households. Not-married households, with their much lower home ownership rate, rose remarkably as a percentage of

households. So although both parts saw their home ownership rise, overall it fell. Here is the change in the mix of American households by marital status:

## U.S. married vs. not-married households

	1985	2015	CHANGE
Married Households	71.1%	57.8%	-13.3
Not-Married Households	28.9%	42.2%	+13.3

This change in the mix of households explains the paradoxical home ownership pattern.

The same pattern also holds strongly for U.S. demographic sub-groups. For example, married black households have home ownership of 64%, significantly up from 1985, and not-married black household home ownership is also up, but the overall black home ownership rate is down:

## Black household home ownership rate

	1985	2015
Married Households	61.9%	64.0%
Not-Married Households	25.1%	30.7%
Overall	44.4%	42.9%

Once again, this odd-looking result is explained by a dramatic shift in the mix of married versus not-married households:

## Black married vs. not-married households

	1985	2015	CHANGE
Married	52.3%	36.7%	-15.6
Not-Married	47.7%	63.3%	+15.6

<sup>1</sup> Sources for the data in this article: Current Population Survey, U.S. Census Bureau; IPUMS-USA, University of Minnesota; R Street Institute calculations.



There is an essential mathematical lesson in all this. You cannot tell what an average means unless you know how the mix of the population is changing. Equally important is the lesson in political economy. Home ownership, the most common modern form of

property ownership, is reasonably argued to have important advantages in social progress and stability for a democratic society. Marriage, as is well documented, has substantial economic and social advantages, especially for children. Marriage and the

rate of home ownership are strongly linked, at least in the United States.

It would be valuable if IUHF research could determine whether this pattern holds true across a range of other countries.

# The state of housing the housing market in New Zealand – trends, policies tried to date and their effectiveness

By Shamubeel Eaqub

## 1. Key points

- The New Zealand housing market is hot
- Auckland in particular is overheated
- The effects are spilling over to other regions
- This is in part due to government policies
- Many new policies have been tried, none are having the desired effect. Some have bought time
- The solutions are known, but politically unpalatable.

## 2. Scene setting

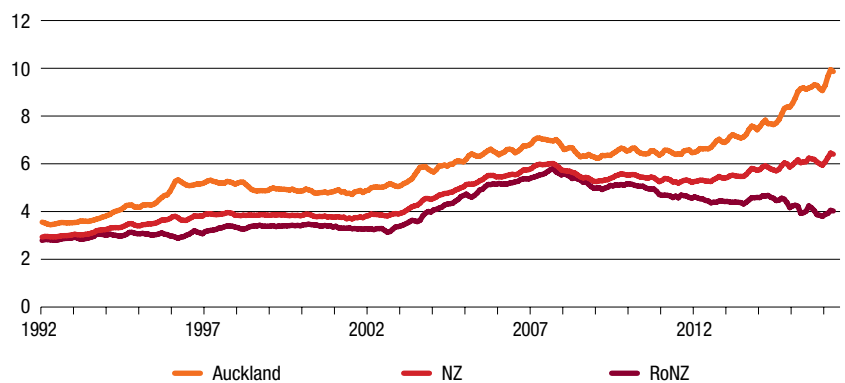
The New Zealand housing market is red hot. House prices rose 8% in the year to April 2016 to almost NZ\$500,000. Auckland house prices rose even faster at 13% over the past year to NZ\$810,000.

Relative to household incomes, house prices are now very expensive. Across New Zealand, house prices are now nearly 6.5 times annual household incomes. This masks significant divergence between Auckland at 10 times and the rest of the country at a relatively affordable – and historically normal – 4 times.

There are very strong cyclical drivers of house prices. Record low interest rates are stoking massive borrowing and investment growth. Record net migration is boosting demand for housing. There are also persistent structural factors at play. Cultural, tax policy and banking policy strongly favour housing investment, creating an upward spiral in prices and debt.

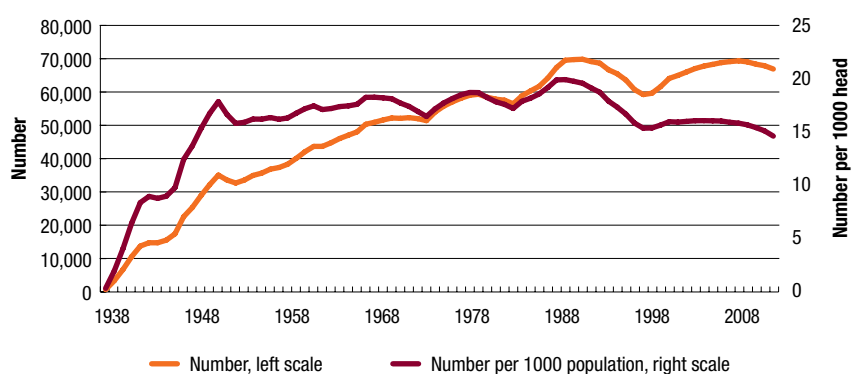
The latest escalation in house prices has been rapid. But that is also within the context of house prices rising faster than incomes since the early 1990s, and is now at the highest level ever. Home ownership rate has also been falling over time – after rising in the post-war period, it has been falling since 1991 and is now at the lowest level since 1956.

Figure 1 House prices overvalued relative to incomes



Source: REINZ, Statistics NZ

Figure 2 State housing supply for poor and vulnerable has not kept pace with population growth



Source: Statistics New Zealand, Te Ara, Housing New Zealand Corporation

While there are sufficient numbers of housing being built through the cycle, it is not accessible to all. Much of the new supply is aimed at the top end of demand and there is plenty of spare capacity (under-occupancy in much of the new supply).

Conversely new supply at the bottom end of the market has become constrained. There is

increasing housing deprivation, seen in long waiting lists for state housing, overcrowding, people living in garages, cars and homelessness. Public sector or state housing supply has not increased since 1991 and on a per capita basis is at the lowest level since 1949.

While there is much political handwringing on behalf Generation Rent, there is also little

political appetite to upset the voting property owning class, who have done very well out of the long property boom.

### 2.1. Policy reactions, gaps & their effectiveness

There have been a number of policy reactions. The Royal Bank of New Zealand [RBNZ] has introduced new policies to restrict lending for highly leverage borrowers and highly leveraged borrowing by investors.

The Government has introduced new policies to clarify capital gains taxes and a requirement for non-residents to register with the tax authority and use a New Zealand bank account. A range of other efforts to increase land and housing supply have also been in force for a few years.

To date, the combined impact of these policies could charitably be described as modest. A harsher pronouncement would be: ineffective.

The policies to date do not get to the heart of the challenges facing the housing market in New Zealand. Incumbent politicians describe the housing boom as merely a 'challenge' rather than a 'crisis'. This forms the basis for implementing ad hoc and weak policy responses to rapidly escalating house prices.

The solutions to the housing crisis are well known. But the solutions are not easy politically. Home owners and property investors are far more likely to vote and they do not want house prices to fall.

We would need a non-partisan and enduring approach to fix the housing affordability crisis in New Zealand. The menu of solutions is below, although we do not go into their detail in this article.

## 3. Individual policies and effectiveness

The big goals behind policies aimed at the housing market are to make houses more affordable and to reduce the risk to the economy from too much debt. As such, the policies tried to date are measured against these two goals.

### 3.1. Macro prudential

The RBNZ has introduced macro-prudential tools to reduce the vulnerability of the financial system to rapidly escalating house prices. The goal has been to reduce the risk of bank failures, by limiting lending to people with relatively low incomes and more recently to investors.

The attempts disrupted markets for around six months each, with little perceptible impact on broader house price trends or debt accumulation. In fact, mortgage debt is now at a new record high relative to the size of the economy.

If anything, these policies simply entrenched the existing disparities in access to credit and housing across between the haves and have nots.

What is required is instead fundamental reform of the basics of the banking sector. The current regulatory regime encourages banks to lend but for existing housing rather than construction of new housing or for business purposes.

Given prices have increased so much relative to incomes, lending measures will only be effective in reducing the amount of new debt if new debt is tied to incomes rather than the value of the collateral. Failing that lending to housing should be treated as risky as any other form of lending.

### 3.2. Restrictions on high LTV borrowers

The RBNZ introduced new macro-prudential rules from October 2013, restricting high loan to value ratio [LVR] (less than 20% deposit) mortgages.

The LVR restrictions were designed to remove highly leveraged borrowers from the market, which has fallen from circa 30% of new mortgages in mid-2013 to less than 10%.

But total lending growth did not slow. The LVR restrictions had an unintended consequence. Banks began to compete more heavily for traditional mortgages, as highly profitable low deposit mortgages were restricted. In the early part of the policy, fixed mortgage rates barely rose despite interest rate increases by the RBNZ.

The policy worked to the extent that there were fewer highly leveraged borrowers. But it did not cool borrowing growth or the housing market.

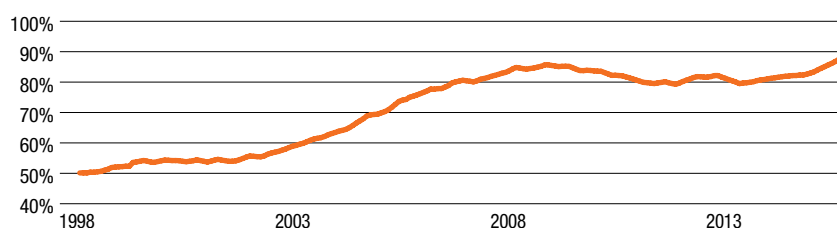
From October 2015 the RBNZ has relaxed some of these restrictions for lending outside of Auckland and introduced new measures for Auckland investors – discussed below.

### 3.3. Restrictions on Auckland investment borrowing

The RBNZ introduced tougher rules for investor borrowing in Auckland, requiring a minimum 30% deposit. The rules kicked in from October 2015.

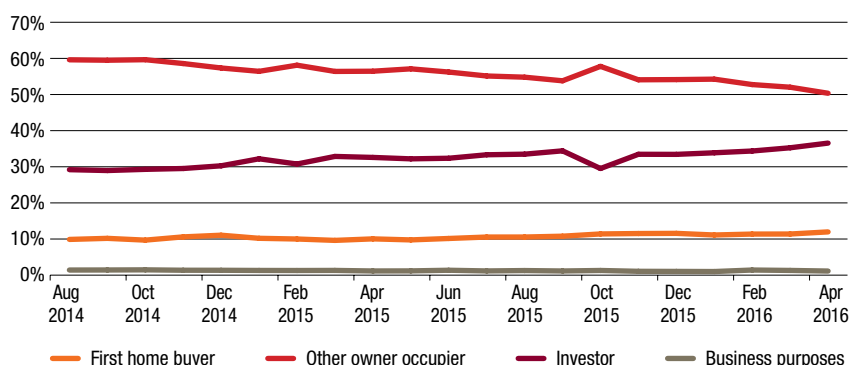
The regionalization of the macro-prudential policy has contributed to escalating house prices outside of Auckland. Banks are more willing to lend to the regions and this is pushing up house prices.

**Figure 3 Mortgage borrowing is now at new record highs**



Source: Statistics NZ, RBNZ

**Figure 4 Investors are becoming more dominant, despite new policies**



Source: RBNZ

Investors also continue to borrow and invest. While there was a momentary blip when the new policy was implemented, an increasing share of new lending is going to investors.

Auckland investors are also spilling over to neighbouring regions, but they are not the dominant influence. Auckland investors accounted for 1.7% of sales in non-home markets before the new policy and 2.2% after – a very small increase in number of transactions.

### 3.4. Central government

The central government has pursued a range of policies. Each has merit, but their design and aspiration have been lacking. Consequently, we have seen no discernible impact on the housing market.

The key policies pursued by the central government have been:

- An agreement between central and local government to significantly increase supply, through relaxed planning provisions. They were named Housing Accords and Special Housing Areas. While there has been plenty of new land supply, new housing supply did not meet targets.
- A draft National Policy Statement on housing outlined that the local authorities could be prosecuted for not releasing sufficient land linked to some kind of price to income ratio. It did not provide any tools to the local authorities to actually release land differently from now.
- New bright line test for capital gains tax – those selling an investment property within two years of purchasing are liable for tax on gains. No evidence yet of this policy changing investor behaviour.
- Non-residents are now required to be tax registered and hold a local bank account. This collects information on non-resident purchases and uses the banking system's anti money laundering processes to limit dirty foreign money entering the housing market. We are yet to see detailed data on this, but non-residents – as defined in this policy – were just 4% of all sales in first quarter of 2016.

#### 3.4.1. Policies to encourage supply

The central government conducted a trial of new planning processes using Special Housing Areas and entered into a Housing Accord with the Auckland Council to agree an enlarged housing and land supply in October 2013.

The plan was to increase the number of new houses and land parcels for new houses by 39,000 units over three years to 2016. This would be a significant step up, from only 13,000 in the previous three years.

While the targets for new supply have been broadly met, they have tended to be sections or land, which are often not yet ready to build on. Actual supply of housing will be more like 25,000 units – a shortfall of 36% from the target.

The still slow supply had been met with very strong net migration in recent years. This has tipped the market from a small shortfall of housing relative to demographic demand in 2013 of around 2,300 units to 21,000 units now.

Slow supply of housing means the shortages have become acute. The stock of vacant houses has fallen from 6.6% of all houses in 2013 to 3.4% now – the lowest since our records began in 1966. Even if the government's ambitious targets were met, housing supply would have just met demand.

The policy instruments did not try to fix the underlying issues for land supply and house building. In particular, local authorities do not have borrowing headroom to fund long term infrastructure. This means that all the development costs need to be paid up front – which increases the cost of land and slows the development process.

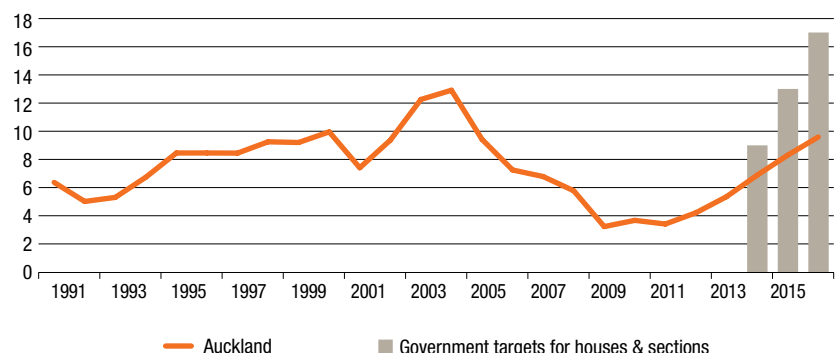
The alternative would be a targeted bond, where the residents benefitting from the new infrastructure repay the debt over a long period of time. Allowing some mechanism for value capture from re-zoning could help too.

#### 3.4.2. National policy statement

The draft National Policy Statement on housing did not present any solutions to known barriers to housing supply. Instead it focused on demanding local authorities to release sufficient land or else face legal proceedings in court.

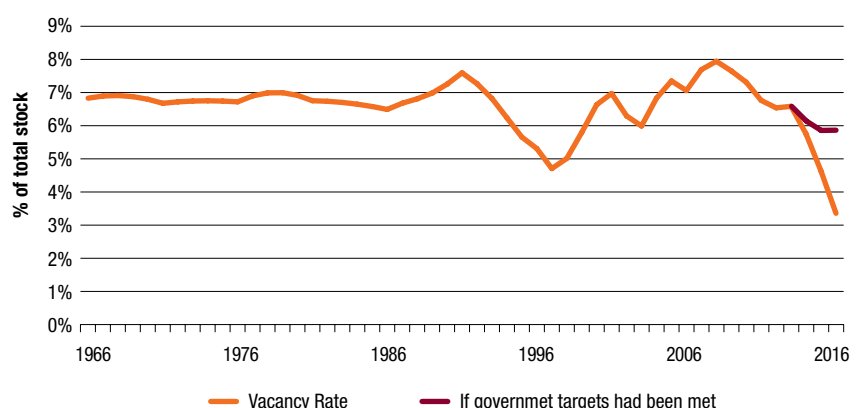
The document did not outline what tools local authorities could use to speed up land supply.

**Figure 5 Auckland housing supply vs government targets**



Source: Statistics NZ, Author's estimates

**Figure 6 Housing shortages are acute**



Source: RBNZ

There is no doubt that local authorities, who are in charge of land use policies, have a large role to play.

Local councils need to have clearly articulated plans and funding arrangements for perhaps a century of expected supply, not six years as is the case in Auckland.

Councils currently are not appropriately funded to deliver the infrastructure, as noted above.

The National Policy Statement was an opportunity to outline the way forward. But it chose to remain with the status quo.

### 3.4.3. Bright line test for capital gains

In the 2015 Budget the government clarified New Zealand's capital gains tax. The tax had been barely used, because it was vague: one was liable for tax if the house was bought with an intent to benefit from capital gains. Under the new rules, investment properties sold within two years of purchase will be liable for tax.

The new policy is unlikely to affect a large part of the market. While detailed data is not available, partial data suggest that investment properties are typically kept for 7-10 years.

The current market is unique in that the Auckland rental market has continued to tighten further. Gross rental yields have fallen to just 3% a year – not enough to cover general outgoings, let alone debt servicing costs. This suggests that investors, who now account for around half of all sales in Auckland, are no longer investors, rather they are speculators.

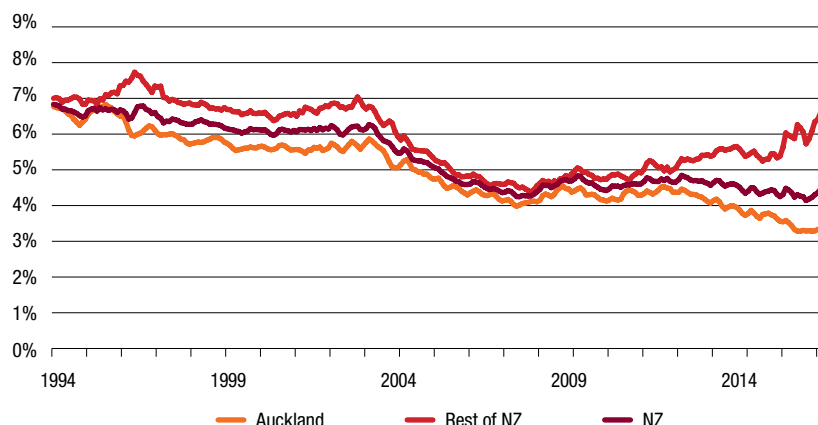
Capital gains tax should be levied on all investment properties, no matter how long they are held. Losses from investment properties should be ring-fenced and not be offset against other income. Also what is known as negative gearing is known to cost billions in Australia and is a welfare benefit for the rich.

### 3.4.4. Non-resident purchases

From October 2015, buyers need to have a New Zealand tax number and the transaction needs to go through a local bank account. This has two impacts: it allows a count of non-resident buyers; and it utilizes the banks' anti money laundering skills to minimise the risk of dirty money entering the country.

The design of the policy and the way information has been collected and reported means that there is only limited confidence in the quality of

**Figure 7 Falling rental yields suggest market driven by speculation on capital gains**



Source: REINZ, MBIE

the data. The early reporting from the responsible ministry suggests that around 4% of house sales were to non-residents in the first quarter of 2015, but it excluded companies, trusts and some types of short term residents.

Until further data is released, it is difficult to verify the scale of non-resident purchases in New Zealand and to understand how their role is changing. Other partial data suggest that perhaps up to 15% of sales are to non-residents.

### 3.5. Local government

The Auckland Council, the local authority at the epicentre of the housing crisis and policy experiments, is also in the process of a significant review of its land use policies, known as a Unitary Plan.

An initial draft Unitary Plan contained significant density (small increase in height across large areas), public transport in addition to expanding to urban boundary. Following community consultation, the density provisions were reduced.

A last ditch effort to re-introduce the density proposals were opposed by an extraordinary meeting organised by councillors representing Nimby neighbourhoods.

The Unitary Plan is currently in front of an independent commission. Their recommendation will then be wholly adopted or opposed by the council. If it is opposed, central government has hinted at appointing its own commissioners – over-riding local democracy in favour of efficacy.

The local authority has been in a difficult position. Density allows better use of existing

infrastructure – but expanding the urban boundary requires very expensive new infrastructure. It currently does not have the borrowing capacity to invest in new infrastructure.

## 4. The way forward

The 'fixes' tried so far have failed to fix New Zealand's housing crisis. Houses are getting more unaffordable and the economy is bloated with debt.

Here are ten policy ideas that, if delivered as a package, would be the enduring solution to the housing crisis.

### 4.1. Palliative care

- Fix the rental market and change attitudes towards renting and property investments
- Build a whole lot of houses, particularly social housing

### 4.2. Short term cyclical solutions

- Use monetary and macro prudential policy to rein in the market
- Clarify immigration policy
- Improve data to identify the impact of foreign buyers, and act on this issue if they are proven to be fuelling housing unaffordability

### 4.3. The real deal: structural solutions

- Increase the supply of housing in high demand areas, be open to changes, deal with Nimby and create sustainable funding arrangements for infrastructure



- Reduce the easy supply of money to housing by reforming banking regulation
- Clarify the existing tax rules on property investment and have a completely open discussion on taxing imputed rent and ring-fencing income from investment properties
- Improve financial markets to provide an alternative to investing in property

## 5. Change in thinking needed

The housing crisis in New Zealand has taken many forms. In this concluding section, the lens of the poor and vulnerable is useful.

There are simply not enough houses for the poor and vulnerable. As a result, those needing emergency accommodation are put in motels and the cost accruing as a debt to the government.

In our history, and globally, we know that market mechanisms are not sufficient to build and accommodate poor and vulnerable tenants.

New Zealand undertook a massive state house building programme to fix this. Much of the social housing in New Zealand is owned by central government. A small amount is owned by local authorities and the charitable sector. The state housing stock increased pretty much

through to 1991. Since then there have been sell-offs by right-leaning governments and new builds by left-leaning governments. But in net we have no more state houses today than in 1991. Relative to the population, we now have the fewest state houses since 1949.

The period since 1991 has also been a period of falling homeownership (from three quarters of households in 1991 to two thirds now). The ranks of renters have swollen, particularly in Auckland. But with new housing supply focused more for the affluent than the poor, there is increasing housing deprivation for the poor.

If we don't build more state houses, the issues around homelessness and emergency housing will only get worse.

But there is little public and political appetite to do so. The same attitude holds back progress in wider policy fixes for the New Zealand housing market.

New Zealanders increasingly perceive the poor as lazy and undeserving of government help. This has probably increased in intensity since the reforms of the 1980s, which placed competition and fiscal probity on the pedestal.

While competition is good in most instances, it also increases tensions between groups,

undermines solidarity and triggers resentment towards marginalised groups.

The poor and other perceived 'free-riders' are strongly excluded from mainstream New Zealand. Creating different classes of New Zealand – fraying the fabric of our society.

This creates the political backdrop of mounting debts for motel charges for those in dire need. This is seen as necessary discipline to stop free-riding.

For those in need of emergency accommodation, life is dire.

Our grudging approach to giving them some shelter at their cost (even if never repaid, this clearly articulates that they are a burden on society) is better than nothing. But it is much worse than what we can be and what we have been – an empathetic society that looks after the poor and vulnerable.

We are small enough and wealthy enough that we could fix the shortage of housing for the poor – injecting a few billion dollars into social housing would do it. The other issues could be solved almost as easily – if the desire was there.

To make progress, we need to rekindle a spirit of nation-building.

# On a subtle balance between micro- and macro- economics: Perspectives in the South Korean housing finance market

↳ By Seung Dong You

## 1. Introduction

The Korean mortgage market witnessed a structural change at the beginning of the twenty-first century. Following the Asian Financial Crisis of 1997-98, financial institutions realized that the housing finance market was like a vast ocean that most of them had not explored over the past few decades. Competition between lenders became fierce; over the first four years of the 2010s, the total outstanding mortgage balance in the Korean mortgage market more than doubled. In addition, housing finance markets were reshaped through a series of mergers and acquisitions and a secondary mortgage market was created.<sup>1</sup>

When the Global Financial Crisis (henceforth the GFC) occurred in the US, policymakers, professionals, and academics began keeping an eye out for issues in the Korean housing finance market. At first glance, most market observers noticed that the primary mortgage market was expanding too rapidly. For instance, growth rates of the outstanding mortgage balance tended to exceed growth rates of total household income. Some observers argued that the expansion of the market would expose lenders to excessive credit risks in the housing market. Second, other observers argue that the characteristics of the primary mortgage market increased lenders' vulnerability to a crisis; most observers tended to focus on lenders' (rather than borrowers') risks. To ensure safe and sound financial markets, guidelines for monitoring the Loan to Value [LTV] and Debt

to Income [DTI] ratios were introduced in 2002 and 2005, respectively.<sup>2</sup>

To manage mortgage credit risks effectively from a macro-prudential perspective, supervisory financial authorities have proposed several mortgage underwriting guidelines including those mentioned above. For stable financial and housing markets, the mortgage market has been tightly monitored and frequently controlled (lgan and Kang, 2011). For example, policymakers officially announced that the proportion of both fixed-rate mortgage loans and amortizing mortgage loans should reach a certain level. From a micro-economic perspective, however, those guidelines may produce some side effects; access to the mortgage market can be limited for some types of borrowers.

This paper discusses recent developments in the housing and mortgage markets in Korea and highlights the policy implications for striking a balance between financial stability and housing welfare. Section 2 briefly overviews trends in both the housing and mortgage markets. Sections 3 and 4 approach the markets from macroeconomic and microeconomic perspectives, respectively. Section 5 concludes by emphasizing the balance between the two approaches.

## 2. Korean housing and mortgage markets

In the early 2000s, the Korean housing market overcame two massive shocks that occurred in the previous decade. In the early 1990s, the

market became stable in nominal terms after skyrocketing in the late 1980s; <Figure 1> shows nominal house price indices for both Seoul Metropolitan Areas (henceforth SMAs) and five large cities including the Busan metropolitan area (henceforth Busan).<sup>3</sup> The first shock, the two-million-unit housing construction drive that was announced in late 1988, began levelling off the upward trend in housing prices. Building five new towns around Seoul was a supply-side shock, particularly in SMA housing markets. Following this shock, real house prices declined in all regional areas beginning in the early 1990s. The second shock, the Asian Financial Crisis in 1997, had several impacts on the housing market (You, 2009 for more details).

The housing market exhibited upward shifts in the 2000s. Notably, local housing markets showed significant variations. According to KB Kookmin Bank, the national house price index increased by 66% from January 2000 to January 2010, whereas it had increased by only 3% over the previous decade (January 1990 to January 2000).<sup>4</sup> Over the 2000s, house prices in Seoul and Gyeonggi more than doubled, whereas over the same period those in Gwangju increased only by 12%. Housing price movements in SMAs are clearly seen in (Figure 1). From 2008 or 2009, however, price appreciation in SMAs began declining, whereas those in other cities began moving in the opposite direction.

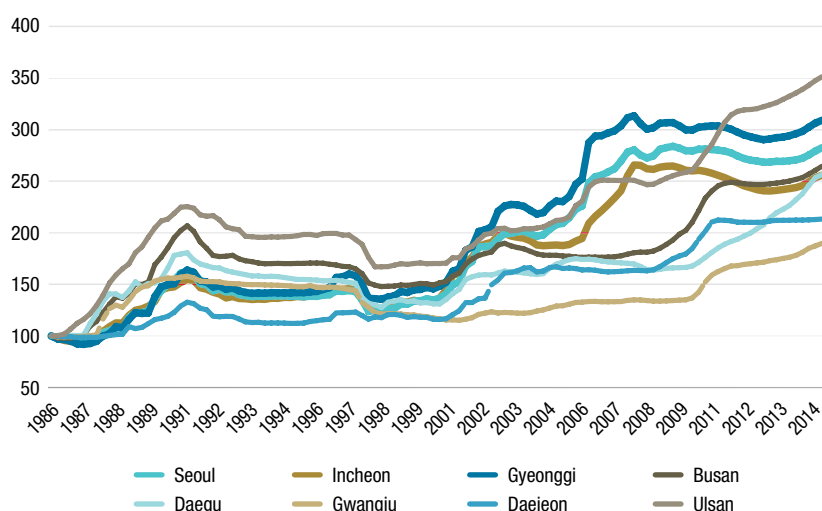
Housing markets became localized and segmented. In real terms, the effects of this trend

<sup>1</sup> In 2001, KB Kookmin Bank merged with the Korea Housing Bank, which was established in 1967 to promote both consumer and producer financing in the housing market. In 2004, the Korea Housing Finance Corporation merged with the Korea Mortgage Corporation, which was established in 1999 to promote mortgage securitization. See You (2003) for details. In 2002, two more financial institutions – Woori Bank and the National Agricultural Cooperative Federation – operated loan programs for the National Housing Fund, one of the largest public funds in Korea, which is managed by the Ministry of Land, Transportation and Infrastructure for low-income earners. Before 2002, KB Kookmin Bank (or the Korea Housing Bank) was the sole originator of NHF loan programs.

<sup>2</sup> To introduce a DTI regulation in the early 2000s, the author and his team worked with supervisory financial authorities for a long time.

<sup>3</sup> SMAs include the Seoul metropolitan government (henceforth Seoul), Incheon metropolitan city (henceforth Incheon), and Gyeonggi-do (or province; henceforth Gyeonggi).

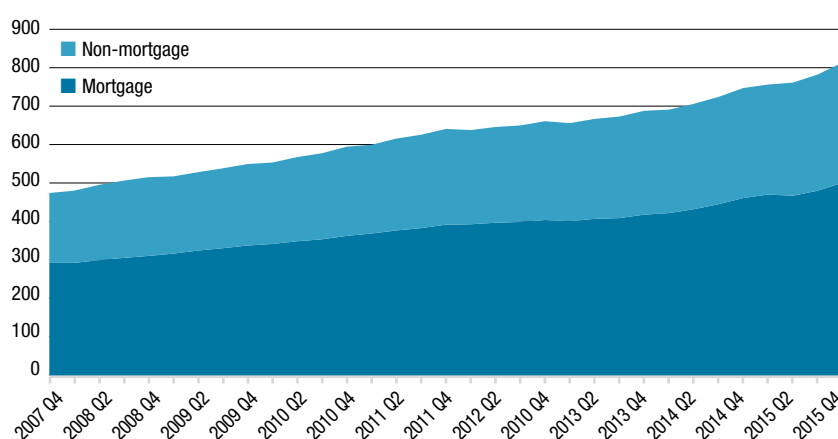
<sup>4</sup> From Jan 2010 to Jan 2016, the nominal house price index increased by 16%.

**Figure 1 Trends in the nominal housing price index by province (1986=100)**


Source: KB Kookmin Bank

**Figure 2 Trends in the nominal housing price index by province (1986=100)**


Source: <http://english.visitkorea.or.kr>

**Figure 3 Household and mortgage debt outstanding from financial institutions (Unit: trillion won)**


Source: Bank of Korea

on regional market performance were more apparent. From 2000 to 2010, real house price appreciation rates in non-Seoul Metropolitan Areas [SMAs] were less than 10%. Among the five cities of Busan, Daegu, Gwangju, Daejeon, and Ulsan, in addition, three experienced negative appreciation. However, the SMAs recorded positive movements; over the decade, real price appreciation rates were 55.5, 55.4, and 44.1% in Seoul, Gyeonggi and Incheon, respectively.

In the 2000s, the mortgage market was reshaped by fierce competition between financial institutions. The outstanding mortgage balance rose markedly. Market size was only KRW 53 trillion in 1997 but it had reached KRW 73 trillion by 2001, according to KB Kookmin Bank. In November 2005, the mortgage market grew to KRW 188 trillion according to the Financial Supervisory Commission (hereafter the FSC).<sup>5</sup> In the fourth quarter of 2007, mortgage loans

outstanding totaled KRW 293 trillion and by the fourth quarter of 2015 it had increased to KRW 501 trillion. In 2005, household debt outstanding was KRW 812 trillion and 62% of household debt is mortgage debt. As shown in Table 1, on average, mortgage balances grew by 7.0% from 2008 to 2015; during the same period, annual personal GDP grew by 5.0% according to Statistics Korea.

Across local areas, mortgage markets did not grow at the same rate. In 2005, for instance, the average rate of growth in the outstanding mortgage balance for SMAs was 5.5% and that for the other five metropolitan cities was 10.2%. Nonetheless, even in SMAs the figure in Seoul grew by 9.6% while in Incheon it grew by only 0.9%. From 2008 to 2015, maximum local mortgage market growth rates ranged from 16.4% to 29.6%, whereas minimum rates ranged from -2.2 to 4.6%.

In addition, most mortgage loans in the market were of short-term maturity, with balloon payments or adjustable rates. In 2004, for instance, only 20% of mortgages had a maturity of more than 10 years, 23% were amortized, and 1.9% were fixed-rate loans; for more details on the characteristics of the Korean mortgage market, see You (2009), and for the effects of mortgage characteristics on an economy, see Miles (2004).

<sup>5</sup> Before 2007, nonetheless, those statistics could not be directly compared, as they had been included in policy papers from financial supervisory bodies. In other words, those statistics were collected only when necessary. The Bank of Korea keeps official statistics on the market size of mortgage and household debt originating in 'official' financial institutions from 2007.

**Table 1 Annual growth rates of local outstanding mortgage balances and GDP per capita**  
(Unit: % and KRW millions)

YEAR		2008	2009	2010	2011	2012	2013	2014	2015
Korea		6,3	8,8	7,2	8	3,1	3,4	10,5	8,5
		21,4	22,6	23,3	25,6	26,9	27,8	28,6	29,5
SMA	Seoul	3,9	6,5	4,7	4	-1,7	0,7	8,6	9,6
	Incheon	6,4	18,2	14,6	11,3	1,2	-2,2	4,6	0,9
	Gyeonggi	8,9	13,8	6,3	5,2	0,9	0,1	8,8	6
METRO CITY	Busan	2,4	3,6	12,5	16,4	10,1	8,8	11,1	8,2
	Daegu	-0,6	0,4	2,7	8,2	10,2	11	22,7	18,3
	Gwangju	15,7	10	14,7	14,1	7,1	6,6	6,9	12,3
	Daejeon	2,3	7,3	14	22,1	5,7	9,3	7,4	1,7
	Ulsan	12	2,8	2,1	14,8	13,8	8,4	16,7	10,4
PROVINCE	Kwangwon	1,9	-2	8,4	8,8	8,6	10,3	5,4	3,8
	Chungbuk	13,6	3,7	2,8	9,5	10,5	7	17,4	11,1
	Chungnam	16,4	11,3	5,9	8,3	-0,9	6,5	20,1	14,5
	Choenbuk	14,5	15,3	16	16,8	10	7,9	7,2	2,6
	Cheonnam	12,7	18	21	22,2	11,2	7,3	6,9	1,8
	Gyeongbuk	12,3	3	9,2	10,9	7,6	13,4	25,3	19,8
	Gyeongnam	4,6	1,2	8,6	21,2	18,1	13,3	15,6	8,5
	Jeju	-2,1	-0,4	9,5	16,4	19,6	17,4	20,2	29,6
max		16,4	18,2	21	22,2	19,6	17,4	25,3	29,6
min		-2,1	-2	2,1	4	-1,7	-2,2	4,6	0,9
GDP PER CAPITA	KRW millions	21,4	22,6	23,3	25,6	26,9	27,8	28,6	29,5
	Growth rate	7,6	5,4	3,5	9,7	5,1	3,3	3,0	3,1

Source: BOK and Statistics Korea

### 3. A macroeconomic perspective on the housing finance market

The Global Financial Crisis taught the lesson that financial institutions may fail to manage their risks (Saunders and Allen, 2010). In the early 2000s, before the GFC, lenders aggressively expanded their loan portfolios into the household sector; according to the FSC, annual market growth rates were 55.8% in 2001 and 53.7% in 2002. These lenders thought that mortgage loan products incurred lower credit risks than any other loan products (You, 2003). In 2005, the annual growth rate of the outstanding mortgage loan balance dropped to around 12%, even though it was much higher than the per capita GDP growth rate (4.2%) or that of household disposal income (4.7%). The growth trend continued even after the GFC; according to the Bank of Korea (henceforth the BOK), the

outstanding balance of household debt was KRW 474 trillion in 2007 but had increased to KRW 812 trillion by 2015.<sup>6</sup>

Both housing and financial market conditions seem to have contributed to growth in the mortgage market. The housing market boom, as analyzed in the previous section, could induce more homeowners or home buyers to take out home equity or home purchasing loans, respectively. It is often believed that the growing mortgage market was a cause of housing price spikes, even though we do not have sophisticated empirical evidence on this relationship. Moreover, due to a low interest rate environment, borrowers could access relatively cheaper mortgage credit than they did in the 1990s. In 2001, for example, an average interest rate for newly originated mortgages was 6.26% but it declined to around 3% in the 2010s; for example it was only 2.90% in December 2015.

Policymakers and market participants suspect that Korean households became more heavily levered over time. They criticize the potential risks in the mortgage market because US mortgage market institutions that had been something of a role model for Korean lenders were severely affected by the GFC.<sup>7</sup> Observing the expansion of the market and the consequences for its characteristics, financial authorities have been proposing that lenders meet loan origination guidelines; such guidelines have been frequently adjusted to market conditions. According to the author's calculations, Loan to Value [LTV] guidelines were adjusted 12 times from 2002 through 2014 and Debt to Income [DTI] ratio guidelines were adjusted 11 times from 2005 to 2014. These guidelines are strict in the sense that, for example, in August 2012 the maximum LTV ratio was 70% and the maximum DTI ratio was 60% for all financial institutions across all regional areas, even though the performance of

<sup>6</sup> According to statistics released by the BOK, the outstanding balance of household debt in Korea was KRW 1,099 trillion as of March 2015.

<sup>7</sup> In 2002, for instance, the Korea Mortgage Corporation, which was the first secondary mortgage enterprise, received technical advisory services on business and risk management from Fannie Mae.

local housing and mortgage markets varies, as seen in the previous section.<sup>8</sup>

From the perspective of financial stability, in 2015 the BOK evaluated potential risks in the household sector by conducting an advanced stress test. Based on its microeconomic data analyses, it argues that financial institutions can manage their credit risks in the household sector; their exposure to risks can be controlled by adequate financial and capital reserves (BOK, 2015: 103). The BOK emphasizes that both bank and non-bank lenders have improved the soundness of their assets in spite of the growth trend.

From the macroeconomic perspective, however, the housing and housing finance markets need to be monitored and analyzed more closely and 'systematically'. The toolkits that macro-prudential authorities wield can be more sophisticated, as current tools must adjust to an unclear decision-making process, which seems to be influenced by random factors. The process has, nonetheless, significant structural consequences for housing and housing finance markets.

#### 4. A microeconomic perspective on the housing finance market

This section addresses the housing finance market from the perspective of market players, of which there are two types: lenders and borrowers. The other market player is the government or financial authority, the viewpoints of which were discussed in the previous section.

The main players in the Korean mortgage market are commercial banks that need to balance loan portfolios between the industrial and household sectors. In 2015, the outstanding mortgage loan balance was about 28.5% of the total loan balance for all savings banks. The total outstanding loan balance was KRW 1,755 trillion, around 46% of which was in household loans, according to the BOK; the outstanding mortgage loan balance comprised about 62% of household loans. Historically, around 60% (less than 65%) of the outstanding household debt balance has been tied to mortgage debt. According to Federal Reserve Bank of New York (FRBNY) Consumer Credit Panel and Equifax, however, 73% per cent of US household debt is related to mortgage loans or home equity loans.<sup>9</sup> Across EU countries, mortgage debt is on average 67% of household debt (Lilico, 2010: 5). Even though Australian mortgage debt was only 56.3% of household

debt in 2013-2014, debt associated with rental properties or shares was 36.5%; more than 90% of household debt was related to household wealth (Natsem, 2015).

Korean lenders seem to think that the mortgage market is attractive; mortgage loans look less risky than any other types of loans. In December 2015, the mortgage loan default rate was 0.28%, which is only about 12% of the default rate for industrial loans, according to the Financial Supervisory Service (hereafter the FSS). Table 3 shows default rates by loan type from 2013 to 2015. In Dec 2015, the loan default rate was on average 1.80%, even though the default rate for industrial loans was 2.56%. The default rate for credit card loans was 1.14% while that for other household loans was 0.51%. From 2013 through 2015, the default rates for mortgage loans were lower than those for any other type of bank loans.

Notably, Table 2 does not include the delinquency rates shown in Table 3. One month after a borrower fails to pay her principal or interest, her debt is classified as a delinquent loan. When the borrower does not fulfil her obligations within a year, her debt is classified as a defaulted loan; after a year passes, the classification is left to the borrower's judgment. In Dec 2015, the delinquency rate for mortgage loans was 0.27%, which made the delinquency rate for household loans low. The mortgage delinquency rate is only around 35% of that for industrial loans. Both default and delinquency rates for mortgage loans are lower than those for other loans that banks hold. Moreover, a mortgage loan provides the bank with collateral that other types of loans often do not.

Borrowers have several incentives to obtain mortgage loans. According to a survey of nine banks conducted by the BOK, the results of which are

**Table 2 Bank loan default rates by sector (Unit: %)**

	2013		2014				2015			
	MAR	DEC	MAR	JUN	SEP	DEC	MAR	JUN	SEP	DEC
<b>DEFAULT RATE</b>	1,46	1,79	1,81	1,73	1,72	1,55	1,56	1,50	1,41	1,80
<b>INDUSTRIES</b>	1,79	2,39	2,38	2,27	2,29	2,09	2,11	2,04	1,91	2,56
Corporations	1,41	2,75	2,65	2,36	2,39	2,28	2,32	2,35	2,13	3,76
SMEs	2,13	2,11	2,16	2,19	2,20	1,94	1,95	1,79	1,74	1,64
<b>HOUSEHOLDS</b>	0,78	0,60	0,65	0,64	0,58	0,49	0,48	0,43	0,40	0,35
Mortgages	0,72	0,56	0,57	0,54	0,49	0,42	0,38	0,35	0,32	0,28
Other HH Loans	0,90	0,69	0,82	0,86	0,78	0,67	0,70	0,63	0,60	0,51
<b>CREDIT CARDS</b>	1,67	1,34	1,42	1,47	1,33	1,11	1,30	1,22	1,14	1,14

Note: Default rate= amount of defaulted loan/total loan outstanding

Source: FSS (Jun 2015)

**Table 3 Bank loan delinquency rate by sector (Unit: %)**

	2012		2013		2014		2015			
	JAN	DEC	JAN	DEC	JAN	DEC	JAN	OCT	NOV	DEC
<b>INDUSTRIES</b>	1,05	0,97	1,11	0,86	1,02	0,77	0,86	0,92	0,99	0,78
Corporations	0,15	0,83	0,86	0,81	1,00	0,57	0,62	0,92	1,02	0,92
SMEs	1,32	1,02	1,19	0,88	1,03	0,84	0,95	0,93	0,98	0,73
<b>HOUSEHOLDS</b>	0,73	0,78	0,90	0,63	0,70	0,49	0,53	0,40	0,42	0,33
Mortgages	0,66	0,73	0,85	0,58	0,62	0,41	0,43	0,31	0,31	0,27
Other HH Loans	0,88	0,89	1,01	0,73	0,87	0,67	0,77	0,61	0,67	0,48

Note: a loan is delinquent if its principal or interests are delayed for more than 1 month

Source: FSS (Feb 2015)

<sup>8</sup> The author heard from a policymaker at a conference that the LTV and DTI ratio guidelines were adjusted to control house price movements.

<sup>9</sup> <https://www.newyorkfed.org/medialibrary/interactives/householdcredit3.pdf> (accessed on May 5, 2017)

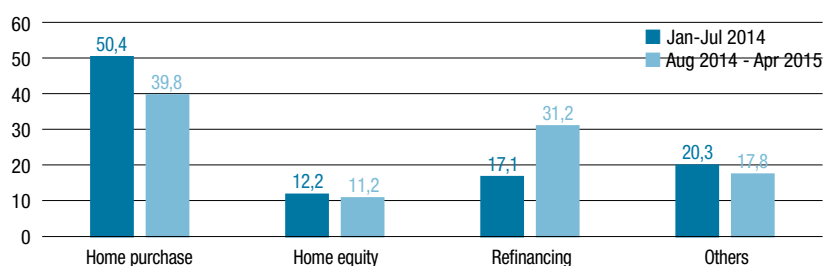


shown in Figure 4, borrowers obtain loans for a range of incentives. Based on the 2010 Census done by Statistics Korea data, the owner-occupancy rate was 54%; the home ownership rate was 61%. Nonetheless, the LTV and DTI guidelines that we discussed in the previous section make no distinction between a home purchaser and a refiner. In other words, due to issues related to existing mortgage loans or homeowners, home purchasers (new borrowers) are very likely to have their access to the mortgage market limited. In 2014, 86.4% of homeowners owned only one house and the remaining owned more than one house. You (2014) argues that a mortgage choice for a borrower who is seeking to buy a house is likely to differ from that for a borrower who has one or more houses. The underwriting guidelines need to take account of varying incentives for borrowers. For example, the effects of the current guidelines on exiting borrowers and new borrowers are commingled.

The rampant use of adjustable-rate mortgages became an issue, reaching a market share of 90% in 2007 (You, 2009). The FSC gave financial institutions a schedule such that, by the end of the year 2017, at least 40% of the mortgages they held in their portfolios will have to comprise both long-term and fixed-rate loans. This guideline has made lenders alter their loan marketing strategies. They have developed a new product, a so-called 'mixed-rate loan', the rate of which is fixed for a certain period of time at the end of which such fixed-rate loans become adjustable. The period is to be determined by the guideline for classifying a loan as fixed; underwriting guidelines are to be developed by loan originators rather than by a financial authority.

In addition, lenders often promote fixed-rate loans to borrowers even though other types of loan might fit their situations better. Nonetheless, the borrower's preference is a critical determinant of the choice of mortgage type (Campbell and Cocco, 2003). Korean lenders seem to have adopted alternative pricing strategies in light of the guideline on fixed-rate mortgage portfolios, although we have no empirical evidence of this.<sup>10</sup> Interestingly, from a borrower's perspective You (2015) suggests that, in terms of borrower preferences, the balance between fixed-rate and adjustable-rate mortgage products remained invariant between 2005 and 2014. Under the financial authority guideline, however, fixed-rate mortgages increased dramatically, as seen in Table 4; the fraction of fixed-rate mortgages, which was only 0.5% in 2010, increased to 23.6% in 2014.

**Figure 4 Purpose of getting a mortgage loan (Unit: %)**



Source: FSS (Jun 2015)

**Table 4 Mortgage loan types**

	2010	2011	2012	2013	2014
Fixed-Rate	0,5	3,1	14,2	15,9	23,6
Amorization with no grace period	6,4	7,7	13,9	18,7	26,5

Source: FSC (Feb 2015)

## 5. Conclusion

The Korean housing finance market has experienced dramatic growth since the early 2000s. With new market structures, moreover, borrower access to the mortgage market has also improved dramatically. Following the GFC, however, market observers began to view housing finance markets with some suspicion. The markets have since then been very tightly monitored, and policy interventions in the mortgage market have been observed frequently; it is believed that recent growth in the mortgage market poses a potential macroeconomic risk from a financial-prudential perspective. The paper suggests a new insight into the balance between the macroeconomic and microeconomic perspectives on the housing finance market; we need to see the forest and the trees at the same time.

In the mortgage market, market players need to make their own decisions or state their own preferences. Competition in Korean mortgage markets may be eroding lenders' profitability and financial soundness. From the perspective of loan portfolio management, however, lenders seem to think that mortgage loans are more attractive than any other type of loan in Korea. In addition, borrowers fall into several categories and their preferences vary according to both financial and non-financial conditions. Fine-tuned policies are needed to achieve housing welfare through the housing and housing finance markets (Dubel,

2009). This paper suggests that market observers should look for a subtler balance between the macroeconomic and microeconomic perspectives on the housing finance market.

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<sup>10</sup> It is known that, not taking a borrower's preference into serious consideration, banks tend to suggest fixed-rate mortgages to meet the guideline.

# Government's role in housing: The case of Singapore

↳ By Shi Ming Yu and Tien Foo Sing

## 1. Introduction

Housing as a basic human need is often viewed as a social good which responsible governments should play a part in providing. In the case of Singapore, public housing development has grown in tandem with the urban transformation over the fifty years since independence in 1965 and one of the most distinctive and ubiquitous features of Singapore's urban landscape are blocks of Housing and Development Board [HDB] flats. Indeed, public housing built by HDB is synonymous with the physical development of Singapore.

Singapore's public housing programme has its roots in the 1960s, when the acute housing shortage called for a low-cost housing model that could meet the people's accommodation needs in the shortest possible time. Housing designs were kept simple and utilitarian – slab blocks of 1-, 2- and 3-room flats came with basic amenities such as piped water and electricity. Although spartan by today's standards, these flats were far better than the slums and rural huts of the past. Following the first Concept Plan for Singapore in 1971, the HDB designed its public housing estates on two basic principles:

- Optimise scarce land resources to meet long-term housing demands which led to the building of high-rise, high-density public housing.
- Provide a total living environment with educational, social and community facilities in sustainable and self-contained new towns.

This paper documents the Singapore government's role in housing over the last fifty years. It tracks the growth and development of the housing market, focusing on public housing and discusses the policy changes to tackle rising house prices in recent years.

## 2. Housing in Singapore

To further understand the housing market in Singapore, a brief background to both public and private housing is useful. The HDB was established in 1960 following the newly elected government in 1959, whose main concerns were housing, education and employment. The state of the nation then was such that permanent housing was simply beyond the reach of the majority and some form of low cost housing was urgently needed. In the preceding years, from 1927 to 1959, the Singapore Improvement Trust [SIT] set up by the British Government in Singapore to provide basic housing proved inadequate. To overcome the severe housing shortage, the HDB embarked upon an ambitious building programme to cater to large squatter communities living in slum conditions. Once the immediate need was fulfilled, the government's focus turned to tuning the housing policy as part of a general nation building programme. Home ownership was encouraged as this would give citizens a stake in the nation and therefore lead them to sink their roots and build their homes. Flats were sold to citizens at subsidized prices for a 99-year lease. By the 1970s, the problem of housing shortage was gradually reduced as HDB increased up its delivery capacity. The 1980s witnessed a shift from basic shelter to the building of communities, with better facilities and amenities, more variety in type and design and the establishment of new towns and housing estates. Rising affluence in the 1980s brought greater social aspirations and higher expectations for public housing. Town planning began to consider factors such as urban form, town structure, and the provision of regional facilities such as parks and open spaces. There was also greater emphasis on streetscape and the building of point-block apartments. The "precinct" concept was introduced to provide each precinct with communal spaces and recreational facilities like playgrounds and fitness corners to facilitate community interaction.

Besides improving the environment, the focus was very much on the building of communities. In 1989, the Ethnic Integration Policy was introduced to ensure that each block, and each precinct, maintains a racial quota that is not too dissimilar from the national distribution. This would have impact on buyers and sellers of the resale flats as the quota could mean that sellers could only sell to a specific ethnicity.

With more than 90% of HDB flat residents owning their own homes, the 1990s was a period of estate renewal, upgrading and the flourishing of the secondary market. In tandem with the economic boom, HDB flat owners were upgrading to bigger flats or to private housing. Greater emphasis was placed on creating a quality living environment and building up the identities of precincts, neighbourhoods and towns. Landmark buildings, landscaping, open spaces and special architectural features were incorporated to achieve a strong visual identity. New residential concepts such as the "Punggol 21" waterfront town were also developed in response to changing lifestyles and aspirations. To meet the changing needs and lifestyles of Singaporeans, public housing has evolved over the years from the basic low-cost housing units of the 1960s to the high quality, reasonably priced apartments that are the hallmark of Singapore's urban landscape today.

Private housing on the other hand existed long before 1960. In the early years of independence, private housing comprised mainly landed properties and low rise apartments in established residential areas in the middle and eastern parts of Singapore. The concept of condominium housing was first introduced in the early 1970s. The introduction of the Land Titles (Strata) Act in 1968, facilitated the development and sale of housing units in multi-unit developments. The expansion of the private housing market was further fuelled from the 1970s when the government, through the Urban Redevelopment authority [URA], made

available state land for sale on 99-year leaseholds. With limited land under private ownership, the Sale-of-Sites Programme under the URA has been instrumental in ensuring the supply of land for private housing.

### 3. Government's role in housing

Government intervention in housing markets is inevitable; it only differs in the extent of intervention and influence. In a speech delivered at the International Housing Conference in 2000, organized in conjunction with the HDB's 40<sup>th</sup> anniversary, the Prime Minister of Singapore, Mr Goh Chok Tong, said: "Though shelter, or housing, is a basic human need, it is an expensive item to produce, especially in urban areas. For most households, housing is by far their largest expenditure, accounting for as much as a third or more of their income. And for those who own their home, it is usually their biggest asset. Thus, when the provision of housing is left purely to market forces, we can expect some segments of the population not to be adequately housed. This gives rise to many social and political problems. It affects the ability of the government to achieve desired economic and social goals. Most governments therefore intervene in the market to ensure that their people can have decent housing."

In Singapore, given the small land area, the government needs to provide the strategic direction and manage the regulatory framework for the housing market. With the majority of the population living in HDB flats, public housing policy is also an important means by which the government hopes to influence social behaviour. The institution of racial quotas to maintain a balanced ethnic composition in HDB estates and the decentralization of estate management responsibilities to town councils are examples where housing policy has been used for non-economic objectives. Even in the private sector, where developers can dictate their own response to changing market conditions, the state, as the largest supplier of land in Singapore, still wields a strong influence through the government land sales programme.

Today, more than 80% of the population lives in HDB flats and of this, more than 90% own their own flat. This makes public housing in Singapore unique, relative to the social housing found in many other countries in three ways.

First, public housing has played a central role in nation-building. As early as 1964, the

government envisaged that home ownership was needed to incentivise a migrant population to settle and build families in Singapore. Today, only citizen families have the privilege to buy new flats at subsidized prices from the HDB under its Build-to-Order [BTO] scheme. Second, public housing is seen not only as a social good in that it provides shelter, it is also a real estate asset that could be monetized for future needs such as retirement. Since HDB owners were allowed to sell their flats after a minimum occupation period in 1981, a secondary resale HDB market has emerged. Relative to their original purchase price, owners typically can achieve capital gains in the resale market. Third, that the market resale value could be maintained is largely due to proper maintenance and management of the public housing estates. Since 1990, town councils were established to manage common areas of public housing estates based on electoral areas. This allowed elected Members of Parliament and the residents to make decisions in the running of the town councils. With enforceable legislation and clear regulations, the public housing estates today are generally well maintained.

Besides physical planning, the HDB regularly reviews the type of flats and housing forms to be built based on the changing demography and life-cycle housing needs of the population. Housing policies have also evolved to respond to the changing needs, aspirations and circumstances of Singaporeans over time. With evidence of an ageing population and a widening income disparity in Singapore, more attention is now being paid to meet the housing needs of the elderly and low-income flat buyers.

Studio Apartments [SAs], for example, were launched in 1998 to provide the elderly with an alternative housing option. The SAs feature a compact design and elder-friendly safety fittings such as grab bars, bigger switches and an alert alarm system. In recent years, HDB re-introduced new 2- and 3-room flats to cater to the housing needs of lower-income groups. Additional subsidies are also given to aid the purchase, ensuring that up to 90% of the population can continue to afford a HDB flat. With more Singaporeans remaining single, the nuclear family rule has also been amended to allow singles over 35 years to buy new 2-room HDB flats.

Another key emphasis of Singapore's public housing policy is estate renewal and rejuvenation. In the 1990s, the Estate Renewal Strategy [ERS]—comprising the Main Upgrading, Interim

Upgrading and Lift Upgrading Programmes—was introduced to bring older towns up to the standard of newer ones. The Selective En bloc Redevelopment Scheme [SERS] was also introduced to enable HDB to acquire older flats for redevelopment, thereby releasing land in prime locations that could be more optimally utilized. Residents affected by SERS are offered new replacement flats nearby so that they can enjoy modern amenities and a fresh lease of 99 years, while retaining communal ties in a familiar neighbourhood. In the next decade, as the number of HDB flats aged 40 to 50 years grows, the need to upgrade and redevelop the older estates will take on greater urgency. One priority area was lift upgrading so that residents of these blocks can enjoy lift access on every floor; the improved accessibility was much needed as the resident population ages. The lift upgrading programme has largely been completed and the focus has shifted to neighbourhood renewal as well as internal improvements to existing flats.

While public housing in the 21<sup>st</sup> century will evolve to encompass a wider spectrum of housing types, the mission of providing Singaporeans with affordable homes in cohesive communities will remain a top priority. And there will always be challenges such as matching supply to demand, adapting to socio-economic changes as well as continued economic growth in order to keep public housing affordable.

### 4. Public and private housing juxtaposition

Housing is not just a consumption good, but also deemed by many as an investment good. Households do not trade houses as frequently as other financial assets because of high transaction costs. Increases in housing prices generate positive wealth effects and induce households' upward mobility on a housing ladder.<sup>1</sup> Households will move to new and larger houses, if increases in prices of their existing HDB flats are large enough to cover their outstanding balances for existing mortgages and down payments for new houses. These households are more reluctant to move in a declining market.

In Singapore, there exists a dual structure in the public housing market, which includes a regulated primary market and a *laissez-faire* secondary market. Owners, who purchase subsidized flats directly from HDB, can only sell

<sup>1</sup> Ortalo-Magne, F. and Rady, S., 2006. "Housing Market Dynamics: On the contribution of income shocks and credit constraints," *Review of Economic Studies*, 73, 459-485.



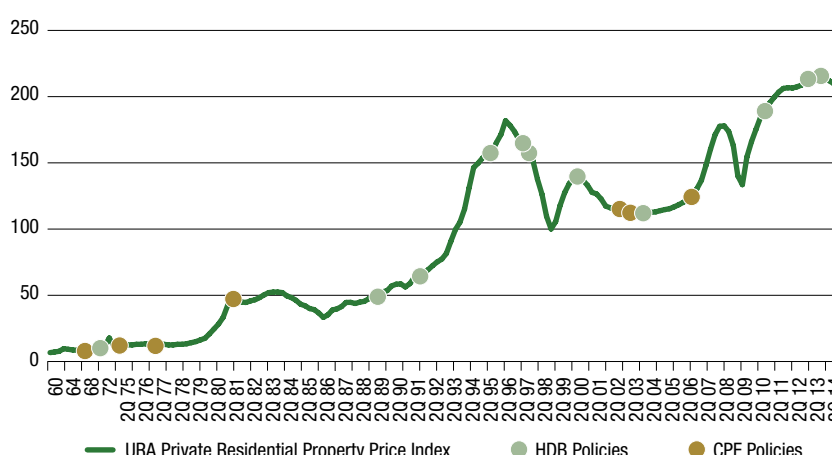
their flats after meeting the minimum 5 years' occupation requirement. Differences in prices between new HDB flats and resale HDB flats allow HDB flat owners to accumulate significant wealth, when selling public flats in the secondary market. This process enables them to realize their "dream" of upgrading to private housing.

Figure 1 overlays selected public housing and CPF policies on the private residential property price trends; and details on each of the policies are summarized in Table 1. It is not surprising to find that these policies significantly influence the HDB resale price changes.<sup>2</sup> However, some empirical studies also show that private housing price dynamics are highly sensitive to changes public housing policies.<sup>3</sup> There are also significant price discovery effects between the private and the resale public housing markets in Singapore.<sup>4</sup>

In 1995, the government introduced a new form of hybrid public housing known as executive condominiums [ECs] aimed to ease the demand side pressure caused by the sharp rising price in the private residential property markets. ECs are 99-year leasehold strata-titled condominium units built and sold by developers to eligible Singaporean buyers, who meet the income criteria (which are higher than the BTO flats) imposed by HDB.<sup>5</sup> ECs are subject to the same 5-year minimum occupation period [MOP] as for HDB flats; and they could be freely transferrable in the open market after 10 years. At the beginning, government linked companies, such as the former Pidemco Land and NTUC Choice Homes, were entrusted to build and sell ECs on allocated state lands. The exclusiveness of the government linked companies was subsequently removed in 1997 by allocating EC lands through competitive bidding exercises. Lum Chang Building Construction was awarded the EC land at Boon Lay Way in June 1997, which was developed into Summerdale EC. Figure 2 shows the distributions of EC lands sold through competitive tender for the period from 1997 to 2015.

The introduction of the ECs as a "sandwich" class to cater to those who are priced out of the private market and yet not eligible for the standard HDB BTO flats has certainly helped in some ways to meet the aspirations of the rising middle class. However, the more critical housing problem, especially in the last decade, has been the rapid escalation of property prices globally,

**Figure 1** Effects of public housing and CPF policies on private housing prices



Source: Realis, Urban Redevelopment Authority [URA], Singapore, REDAS, the Author

**Table 1** Selected public housing and CPF policies that may impact on the private housing market

YEAR	HDB RULES	CPF RULES
APR-1968		CPF Home ownership Scheme
MAR-1971	HDB resale market was established	
MAR-1975		Use of CPF on HUDC flats
MAR-1977		Use of CPF on Ministry of Defense Housing
JUN-1981		CPF Approved Residential Property Scheme
AUG-1989	HDB resale rules were relaxed	
OCT-1991	Single Singapore Citizen Scheme	
AUG-1995	Executive Condominium scheme was introduced	
APR-1997	Regulations on HDB mortgage finance	
SEP-1997	5 year Minimum Occupation Period to buy private properties	
JUN-2000	Rules of private property purchases by HDB owners	
JUL-2002		Revision of CPF withdrawal rules on housing purchases
MAR-2003		CPF minimum sum limit raised on 1 July 2003
OCT-2003	Relaxing of HDB subletting rules	
JUL-2006		Restrictions on multiple property purchases; Phasing Out of Non-Residential Properties Scheme [NRPS]
AUG-2010	Concurrent ownership of HDB and private within MOP is not allowed	
JAN-2013	Permanent Residents [PRs] not allowed to sublet whole flats; PRs must sell HDB flat within 6 months of purchasing private properties; SSR on industrial properties and land: 15%, 10% and 5% if sold in 1 <sup>st</sup> , 2 <sup>nd</sup> and 3 <sup>rd</sup> year respectively	
AUG-2013	Mortgage servicing ratio; PRs to wait 3 years before buying resale HDB flats	

Source: Realis, Urban Redevelopment Authority [URA], Singapore, REDAS, the Author

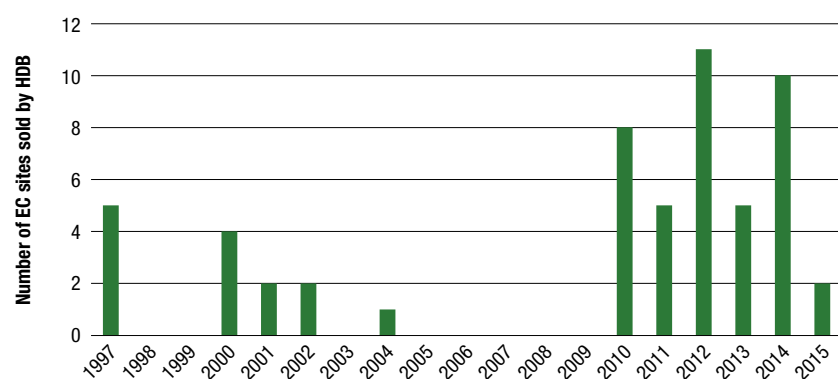
<sup>2</sup> Tu, Yong and Wong, Grace K.M., 2002, Public Policies and Public Resale Housing Prices in Singapore, *International Real Estate Review*, 5:1, 115 – 132.

<sup>3</sup> Sing, Tien Foo, Tsai, I-Chun and Chen, Ming-Chi, (2007), "Price Dynamics in Public and Private Housing Markets in Singapore" *Journal of Housing Economics*, Vol. 15, No. 4, pp. 305-320.

<sup>4</sup> Ong, Seow Eng and Sing, Tien Foo, 2002, "Price Discovery between Private and Public Housing Markets," *Urban Studies*, 39(1), 57-67.

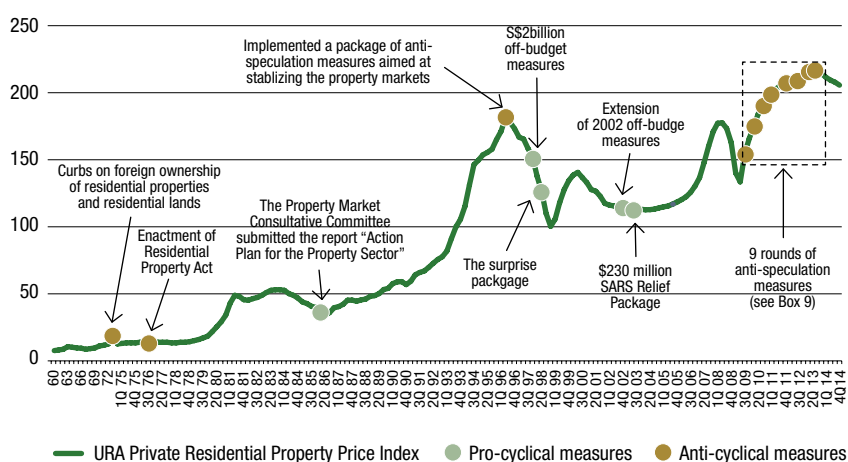
<sup>5</sup> The income ceiling was set at S\$10,000 per month when ECs were first introduced. The income ceiling has been revised to S\$12,000 per month with effect from 15 Aug 2011.

**Figure 2 Sales of EC sites by HDB**



Source: HDB

**Figure 3 Government's interventions into the private residential property market**



Source: Realis, Urban Redevelopment Authority (URA), Singapore, REDAS, the Author

as witnessed in the East Asian cities in China, Korea, Taiwan, Hong Kong and Singapore. To curb rising prices, most governments had to directly or indirectly intervene in their property markets to ensure that housing would remain affordable to their people. In Singapore, the government has clearly played not only a direct role in the provision of public housing but has also effected policy changes over the years to ensure that the residential property market as a whole remains stable and sustainable.

## 5. Housing market interventions

As the information flows in the property market are less perfect and inefficient relative to other asset markets, market distortions could be created by irrational investors. Speculators or informed investors could make use of their information advantages to earn abnormal profits. Therefore, in the private property markets, if left alone without restraints, prices could deviate far away from the fundamentals causing large losses economically and socially on some home buyers. Therefore, the government takes a pro-active approach from time to time to intervene in the market to smooth out unnecessary and extreme volatility in the market. Figure 3 shows the past government interventions into the private residential property markets, and Table 2 provides details of the policy measures.

In 1985, Singapore experienced the first most serious economic recession in the post-independence period. The Minister for Finance formed a Property Market Consultative Committee [PMCC] composed of representatives from government agencies, private sectors, and academic, to evaluate the problems facing the property markets and provide recommendations. In February 1986, the committee, chaired by Dr Toh Peng Kiat, the then Director at the Revenue Division, Ministry of Finance, submitted its report - "The Action plan for the Property Sector", that proposed three-pronged strategies to address the depressed property market. Real estate investment trusts [REITs] were mooted as one of the strategies to boost demand in the market, but the REIT market did not take off till July 2002. The turnaround of the private property market started in Q2 1986 shortly after the PMCC's report was submitted.

Compared to the 1986 recession, the market downturns after the 1997 Asian Financial Crisis were prolonged and sticky. Beseet by multiple negative events, the private property market witnessed two consecutive price declines: Q3 1996 - Q4 1998 and Q3 2000 - Q1 2004, lasting for two years and four years, respectively. The private residential market dropped into the

**Table 2 Government's Property Market Stimulus Measures**

YEAR	PRO-CYCLICAL MEASURES	POLICY DETAILS
NOV-1997	The surprise package	Government sale sites deferred; review set for second half 1998. Extended Project Completion Period [PCP] for residential projects from 4-5 years to 8 years; private residential land sale sites to be sold in 1998 and 1999 would be tendered out with PCP of 8 years. Also, extension of PCP for foreign companies by up to 2 years. Premium of 5% of land price per year of extension applies unless there are technical grounds for the delay. Suspension of stamp duty surcharge on sale of properties within 3 years of purchase on or after 19 Nov 97.
JUN-1998	\$2billion off-budget measures	To suspend government's land sale till 1999, and to defer stamp duty payments till TOP or completion for the purchase of uncompleted properties
DEC-2002	Extension of 2002 off-budget measures	GLS Confirmed List suspension extended to H1 2003. Defer the release of BFC site for sale in 1H2003; fixed rebate of up to \$8,000 per year for all commercial and industrial properties; 30% rebate for the remaining property tax payable.
APR-2003	\$230 million SARS Relief Package	Additional property tax rebates for commercial properties. The existing property tax rebates for commercial properties will be enhanced by an additional rebate of \$2,000 plus 10% of the balance property tax payable in 2003.



doldrums with 18,205 unsold condominiums units in the pipeline as of Q2 2001 (*Source: the Urban Redevelopment Authority, URA*). The government introduced four rounds of pro-cyclical stimulus to revive the markets, which included the 2002 off-budget, the surprise package, the extension of the off-budget package and the SARS relief packages. The Minister of National Development of Singapore, who oversees the property market activities, commented after the announcement of the off-budget measures:

*"...off-budget measures to stabilize the property market will not have an immediate effect, but will help boost confidence and help the real estate industry ride out the downturn. The measures will not on their own help the real estate industry to recover. Ultimately, the recovery of the real estate sector will depend on the recovery of the economy as a whole."* – Mr Mah Bow Tan, Minister for National Development in 'The Business Times', Singapore (Rashiwala, 2001)

In the last 50-years of private property cycles, the government only intervened twice into the market via anti-cyclical measures; in 1995 and then between 2009 and 2013. The periods starting from Q1 1991 to the peak in Q2 1996 witnessed the longest consecutive quarter-to-quarter growth in the URA private residential property price index. The price index doubled between Q2 1993 and Q2 1996; and on a compounding basis, the growth rate was computed at 23.8%. The unprecedented rate of growth in the private property prices significantly dwarfed the compounded quarterly growth of 5.92% in earnings over the same period (*Source: The Central Provident Fund (CPF) Board Statistics*).

The government acted swiftly and decisively by introducing a slew of measures to cool the overheated market on 15 May 1996.<sup>6</sup> The measures include restricting loan-to-value ratio of property loans to 80%,<sup>7</sup> and imposing capital gain tax and seller's stamp duty on residential properties sold within three years of purchases. The government also stepped up its sales of state lands program to increase the private housing supply from 6,000 units to 7,000-8,000 units. These anti-speculation measures coupled with the 1997 Asian Financial Crisis contributed significantly to the decline in private residential property prices. The prices dropped by 44.9% from the peak of 181.0 points in Q3 1996 to 100 points in Q4 1998.

The second bubble in the private residential property market started to form from Q2 2004, but was interrupted by the sub-prime crisis and the bankruptcy of Lehman Brothers in 2008 (resulting in the Global Financial Crisis). However, private residential property prices took a V-shaped rebound in Q3 2009 culminating in their peak in Q3 2013. During the strong build up in private residential property prices from 2009 to 2013, the government introduced nine rounds of cooling measures (Table 3), which include various macro-prudential tools (such as the LTV limits, total debt servicing ratio [TDSR], mortgage servicing ratio) and transaction taxes (such as seller's stamp duty [SSD] and additional buyer's stamp duty [ABSD]). These were

aimed at curbing irrational market activities that cause overheating in prices.

Apart from its direct role in public housing, the Singapore government also indirectly influences the private residential property market in several ways. First, it does this by creating competition via its related real estate development companies such as Keppel Land and CapitaLand. Operated as public entities listed on the Singapore Exchange, these government-linked companies will have to compete with other private real estate developers on a fair and level playing field. There are no special concessions and privileges assigned to these firms, and therefore, it is important for these

**Table 3 Government's anti-cyclical measures**

YEAR	ANTI-SPECULATION MEASURES	POLICY DETAILS
OCT-1976	Enactment of Residential Property Act	Foreigners are only allowed to buy private apartments in buildings of six levels or more, or flats in condominiums where ownership is by strata title. Permanent Residents [PRs] can apply to the Law Minister to buy landed properties
MAY-1996	Implemented a package of anti-speculation measures aimed at stabilizing the property markets.	80% financing restriction for property purchase; 7,000-8,000 residential units to be released in 1997; 30-month project completion period [PCP] for private developments under QC scheme; 5% p.a. penalty imposition for PCP extension; stamp duty extended to buyers of all sales and sub-sales of uncompleted properties; new stamp duty on those who sell properties within 3 years; tax on gains from properties sold within 3 years of purchase.
JUL-2005	MND announced rules on down-payment and LTV	MND announced changes in policies affecting property market: To raise loan-to-value ratio from 80% to 90%; to reduce cash down-payment from 10% to 5%; to allow unrelated singles to jointly use their CPF savings to buy private residential properties; to phase out non-residential properties scheme in July 2016; and restrict the use of CPF on multiple properties purchases
SEP-2009	Round 1 Anti-speculation: Removal of Interest Absorption Scheme [IAS] and Interest only mortgage [IOM]	See details in Table 4
FEB-2010	Round 2: LTV and Seller's Stamp Duty	
AUG-2010	Round 3: extension of SSD periods	
JAN-2011	Round 4: Enhance SSD rate and periods / LTV	
DEC-2011	Round 5: Additional Buyer's Stamp [ABSD]	
OCT-2012	Round 6: Loan tenure, and LTV	
JAN-2013	Round 7: ABSD rate increase and LTV further tightened	
JUN-2013	Round 8: Total Debt servicing ratio [TDSR]	
AUG-2013	Round 9: Maximum loan term and Mortgage Servicing Ratio	

<sup>6</sup> The measures implement by the government to check the sharp rise in private residential property prices include imposition of a 80% loan-to-value limit on bank loan, levies of capital gain tax and seller's stamp duty for residential properties sold within three years of purchase.

<sup>7</sup> Prior to the May 1996, loans of up-to 90% of valuation were provided by banks to purchasers of private properties.

<sup>8</sup> Bailey and Baumol (1983) defines contestable market as "if no price in that market can be in equilibrium when its magnitude is such as to enable an entrant to undercut it and nevertheless earn a profit", which suggests an even smaller number of firms are able to achieve efficiencies, no excess profit, no cross-subsidy, and marginal cost pricing as in a competitive market. [Reference: Bailey, EE, and WJ Baumol 1983. Deregulation and the theory of contestable markets. Yale J. on Reg. 1:111.]

firms to operate efficiently and professionally to survive in a highly contestable market.<sup>8</sup>

### 6. Conclusion

Since its independence in 1965, Singapore has transformed from a third world developing state into a first world global city. The government has played an active role in this transformation. It has been involved indirectly through its various agencies in providing and managing the hard and soft infrastructure as well as being the policy maker and regulator. It has also directly played the role of developer for public housing. Today, the success of its public housing is well documented with more than 80% of its people living in these public housing estates while more than 90% of its citizens own their homes. This paper has discussed the growth and development of housing in Singapore and the policy changes and interventions by the government in the housing market.

Going forward, a major challenge that Singapore, as with many other countries worldwide, will increasingly face is the housing of an ageing population. In Singapore, the number of senior citizens aged 65 and above will increase three-fold from 226,000 in 2000 to 796,000 by year 2030. In terms of the total population, the proportion of the aged will rise from 7.1% to 18.9% over the same period. These demographic trends will have a major impact on the care and support for elderly residents. The challenge is to build an environment where young and old alike can enjoy a fulfilling life together. The HDB has started building studio apartments for the elderly, locating them in mature towns that have easy access to transport and public amenities. It has also started to introduce technology in the homes which will help with the monitoring of the elderly.

Another major global challenge is to build a sustainable environment of which housing is

the most important component. Singapore developed a sustainable blueprint in 2015 which outlines the national vision and plans for "A livable and endearing home", "A vibrant and sustainable city", and "An active and gracious community". The government has been actively promoting green buildings as developers are motivated to embrace a green and sustainable approach in their projects through using advanced technology to improve energy, water, and circulation efficiency in buildings, including adopting clean energy such as solar panels.

Notwithstanding these future challenges, housing will remain an emotive and enduring aspect of human endeavor. It will mean that governments will and must continue to be involved in its creation and provision.

# The global urban housing crisis and private rental in the Anglophone world: future-proofing a critical sector and tenure

↪ By Steffen Wetzstein<sup>1</sup>

## 1. Introduction: Global Housing Crisis and Private Rental

There is a global housing crisis in the making, as access to affordable and decent housing is becoming a central issue around the globe. In growing metropolitan regions, current urbanisation and re-urbanisation patterns coincide with decreasing real household incomes while ineffective administration and regulation struggles to channel public and private investment into desperately needed housing development. In the most prestigious locations, rising inequality is driving house prices even higher with flow-on effects throughout many other urban housing submarkets (Berry, 2014). As a result of these market and governance failures, attractive western cities from London to San Francisco, Stockholm to Munich and Sydney to Vancouver face dire consequences; housing affordability reaches all-time lows, poorer households are being priced out of inner-city neighbourhoods and the size, quality and design of the available housing stock becomes increasingly inadequate even for basic, modern living (Pittini, 2012). Disturbingly, this persistent structural crisis has not been mitigated after the Global Financial Crisis but rather has accelerated (Kemp, 2015).

The crisis-related debates in the media and politics – especially in the Anglophone world – are largely dominated by the effects on homeownership and social mobility, and to a lesser degree on social housing. This bias in attention reflects the rising fear of a society that is poised to lose one of its foundational, cultural-aspirational values: the private ownership of land and housing for many. While these sectors are doubtlessly affected, the most immediate allocation issues and most acute social problems arise elsewhere; in the private rented sector [PRS]. As homeownership becomes too expensive for

those on moderate and even middle incomes, and sizable (re)investment in social housing is viewed as too expensive for many governments, more and more households are left with no option than to compete for housing in the PRS. These seismic shifts are threatening now to transform even the United States into a ‘renter nation’ (The Right to the City Alliance, 2014). In England, for example, private rented housing is the only growing housing tenure (Wilson and Johnson, 2013), landlords with mortgages now have more housing market equity than occupiers with mortgages (Armstrong, 2016) and the private rental housing stock is expected to almost double to more than a third by 2032 (Carter Jonas, 2015). Many cities have reached record rent levels as ‘generation rent’ (Eaqub and Eaqub, 2015) is pushing demand to new extremes. An end to this crisis is not in sight as almost half a billion of urban households are projected to face crowded, substandard housing conditions in ten years’ time (McKinsey Global Institute, 2014).

This paper discusses the state and prospects for private rental from a perspective of the Anglophone countries. The approach to utilise evidence from Australia, Canada, England, Ireland, New Zealand and the United States has been chosen not only because these countries are facing the worst affordability outcomes in the West. The Anglosphere also matters because it has been at the forefront of globally spreading policy development; a fact that makes it likely that other jurisdictions will follow their political-administrative responses to this crisis. The argument builds on the premise that housing is an essential good like food and clothes, and should therefore be treated differently to consumer products or commodities. The author advocates sector reforms aimed at transforming private rental from a short-term, speculative form of investment with increasingly

unaffordable and unjust outcomes into a viable, affordable, secure and long-term oriented housing choice for tenants and investors.

## 2. Private rental in the Anglosphere

In the Anglosphere private rental performs a different role compared with other cultures (Crook and Kemp, 2014). While Germanic countries, for example, feature large scale and state-supported private rented sectors, their counterparts in the Anglophone world have historically been relatively small and often received few or no capital subsidies in comparison to strong social and homeownership sectors. In this context, the PRS in England – despite being larger than the social rented sector – has often been described as having a ‘residual’ role in accommodating low-income households unable to gain access to social housing (Kemp, 2011). The Anglosphere generally considers free market rents and weak security of tenure as vital ingredients of the system; a strategy that makes this tenure a highly liquid investment (Kemp and Kofner, 2010). The advantage for tenants lies in the flexibility that creates the ability for households to be mobile in response to changing personal and labour market needs (Hulse, 2012). The differences in sector size are an outcome of country-specific regulatory regimes and the relative attractiveness and accessibility of other housing tenures as well as the availability of other investment opportunities (Whitehead et al., 2012). Often, differences are a direct reflection of the experience of the sector during the 20th century (O’Sullivan and De Decker, 2007).

While the sector only played a relatively small role three decades ago (Bovaird et al., 1985), changing western housing policies lifted its competitive position (Van Der Heijden and Boelhouwer, 1996). In the Anglosphere in

<sup>1</sup> This work was supported by the Fritz Thyssen Stiftung für Wissenschaftsförderung (grant number 10.15.1.014S0).

particular, the investment focus has increasingly shifted from maximum yield to short-term capital gains. At the same time, private rental is slowly moving from being a tenure of transition to increasingly one of longer-term occupancy. Nevertheless, as 54% of private renters have been in their properties for less than two years and of these 35% for less than one year, it is still appropriate to call it a short term tenure.

Today, the sector accommodates households across a number of substantial niche markets. In the United Kingdom (UK), for example, there are young professionals (often forced to rent), the generally growing submarket of domestic and international students, people on housing benefit and those in so-called slum rental at the bottom end of the PRS, asylum-seekers and immigrants for whom private rental is more immediately accessible than other tenures, middle market renters (often temporarily in this sector following changes in job or household reconfiguration), lifestyle-renters on high incomes and high rents, people who rent directly from an employer, those on temporary accommodation (including those linked to state funding arrangements) and older tenants and regulated tenancies (Rugg and Rhodes, 2008).

### 3. Crisis impact on private rental: shifting power balance and rising demand

Over recent decades, Anglophone private rental has moved towards a *short-term, speculative and largely non-institutional form of investment*. Today, speculative market behaviours such as land banking where land is secured in soft markets and stored for future development, and the 'buy-to-leave' phenomenon where rich overseas investors leave property empty and still benefit from rising values, are widespread (Heywood, 2012). Much of the sector growth in the UK can be linked to the 'buy to let' scheme; a vehicle for speculative investment and securing long-term financial security through capital gains via property (Leyshon and French, 2009). In addition, private rental outside the US still suffers from not attracting enough institutional investors as three quarters of UK landlords, for example, are individuals and couples. Clearly, as an individual material asset, tradable commodity and speculative investment tool housing has become central to people's lifelong wealth accumulation and risk management strategies.

The housing crisis generates increasingly *unaffordable, insecure and inadequate private rental housing*. Rising rents as an outcome of supply not meeting demand decrease housing affordability,

weaken tenants' rights, create unwanted mobility and social disruptions, and low quality housing produces physical and mental health risks. The latter fact is often overlooked. In New Zealand, for example, close to half of all rented housing stock – almost double the respective figure for owner-occupied homes – is in 'poor condition' (Collins, 2016), and almost two thirds of UK renters have suffered damp, mold or leaking roofs (Owen, 2014). Private renting today is clearly characterised by increasing volatility and instability, even though it is well known that problems associated with insecure housing can lead to failed tenancies and costly disruption both for households and governments through the subsequent need for homelessness support interventions or entry into social housing (Stone et al. 2015). In sum, unaffordability, insecurity and low quality severely compromise traditional functions of the home as shelter provision, site of social reproduction and source of ontological security. So while the most vulnerable individuals are to be found in the social rented sector, private rental has become the most vulnerable housing sector.

In the growing metropolitan regions of Anglophone and other western countries, private rental is likely to experience (sharply) *rising demand* in coming years because of intra- and extra-societal shifts. First, there is downward pressure as people priced out of homeownership for a variety of reasons including stronger house price inflation relative to people's income, rising cost of education (e.g. student loans) and globalised, inflated property markets are forced to rent privately. Second, there is upward pressure as people unable to access decreasing social housing are condemned to compete in private rental markets. In addition, pressure from within society (increasing household formation) as well as pressure from outside society (relocation, immigration and international students) are further adding to demand. As a result, the private rented sector will assume an expanded and thus prominent role compared to the past. But if regulation basically remains unchallenged, these high expectations of providing homes for a substantial number of additional households will only lead to rising rents, stark location and unacceptable quality choices for increasingly disempowered tenants. This undesirable and shameful scenario calls for a challenge to the status-quo in several respects.

### 4. Seven strategies for future-proofing private rental as sector and tenure

First, a *philosophical-cultural shift* is necessary to make private rental a legitimate and

respectable investment and tenure choice in the Anglosphere. Rather than a transitional, 'in-between' housing choice, this tenure needs to become a viable and attractive alternative to homeownership and social renting that are still deemed more desirable (O'Sullivan and De Decker, 2007). This image change requires a deep-seated questioning of the dominant liberal aspirations of individual responsibility and social mobility as well as established cultural attitudes that construct private tenants as foolishly 'paying off someone else's mortgage'. The new vision needs to be driven by politicians, opinion-leaders, the intellectual and professional classes as well as the general media. This paradigmatic change is fundamental if private rental is to assume a central place in now increasingly talked-about tenure-neutral policy frameworks designed to combat unaffordable and inadequate housing (Elsinga, 2015).

Second, a *shift towards long-term structures* for both investment and tenure is necessary. Only strong political will, well-designed regulatory reform and effective state incentives will transform Anglophone private rental from a short-term, speculative investment and a volatile, insufficiently protected tenure to a long-term, sustainable societal arrangement to adequately house (urban) residents in the 21<sup>st</sup> century. This transformation requires political prioritisation of all forms of housing development (e.g. newly-build stock, expansions, renovations, conversions and densification) over other forms of investment like shares and commodities. Part of the solution is to base mortgage supply on long-term sources of finance, and to overhaul tax-systems in favour of long-term investments (Armstrong, 2016). Effective capital gains tax legislation is pivotal in countering speculative investment behaviours. On the tenure side, legal conditions need to put into place to promote long or indefinite tenancy agreements as well as long terms notices as it has been long common in Germanic countries.

Third, *re-balancing the power between landlords (currently winners) and tenants (currently losers)* is paramount if principles of balance, fairness and equity – the foundations of participatory democracy – shall continue to guide intra- and intergenerational social relations. Pivotal is the strengthening of tenants' rights in the areas of affordability, security and quality of housing (Easthope, 2014). Rather than a 'freedom of contract' model, affordable rents under current crisis conditions require effective forms of price-based regulation that limit the rent increase in urban private rental markets in line with a measure of inflation. Moreover, the security-related rights of tenants need to be reappraised and legally adjusted in light of



recent academic work on 'secure occupancy' (Hulse and Milligan, 2014) as well as in comparison with other countries (Kemp and Kofner, 2010). Finally, and in accordance with the UN human rights to adequate housing (United Nations, 1948), rental quality standards need to be lifted to avoid disinvestment, eradicate slum housing and mitigate costly health risks.

Fourth, *accommodating many more low- to moderate-income households* is critical as those households and families are forced to rent privately more so now than ever before (Stone et al., 2015). In Australia, households falling into the lowest 40% of income now consistently face extremely unaffordable rents (Community Sector Banking et al., 2015), and key workers such as teachers and police officers who are providing essential services are pushed out to, or beyond, the urban periphery (Gair and Saulwick, 2015). To privately supply sufficient affordable and adequate housing stock for this substantial target group constitutes a massive contemporary challenge (Yates and Wulff, 2000). One way forward could be the establishment of new forms of public-private partnerships where land and land management remains in the hands of the state, while private developers build on a fixed-cost basis and private landlords lease property at agreed, affordable rates long-term to the 'working poor'. In addition, key workers could be covered under specific contractual arrangements and tax-supported employer-based housing could be revived again (Wetzstein, 2011). Importantly, the housing benefit model as prevalent in the UK needs to be overhauled because it further inflates rents (Bentley, 2015).

Fifth, the further *institutionalisation of the sector* is likely to positively affect the structure and quality of provision (Pawson and Milligan, 2013), and could potentially kick-off a desperately needed wave of new housing construction. The key to channeling much needed private equity into this sector in London, for example, lies in greater institutional interest, support and activity (Carter Jonas, 2015). Since institutional investors are well positioned to competitively access capital, source building resources and exploit economies of scale on the basis of longer-term investment horizons, institutionalisation – theoretically – also promises the achievement of broader societal investment goals such as increasing energy efficiency, raising quality standards of materials and construction as well as promoting old age- and disability-specific improvements. The key problem in England, however, is that the rate of rental return continues to be too low to attract large-scale institutional investment outside London and except in certain niche markets

like purpose-built student accommodation. It is also somewhat questionable whether Real Estate Investment trusts (REIT's) – a combination of capital from many investors to form a fund to acquire or provide financing for all forms of real estate – could play an important role because on their own they are unlikely to resolve the problems associated with the lack of new housing supply in the UK (Jones, 2007). Institutionalisation in the form of (further) professionalised rental housing management, in contrast, could clearly and quickly add transparency and procedural efficiency to the sector.

Sixth, *spatially-sensitive policy interventions* and associated knowledge production should result from a new appreciation of the increasing spatial unevenness of housing outcomes. Clearly, rental markets in London, Auckland or San Francisco differ markedly from the rest of their respective countries. Notwithstanding the ongoing importance of differing national housing systems (Whitehead and Williams, 2011), uniform, 'one size fits all' national interventions are often too crude to be effective in the global urban age (Crook and Kemp, 2014). Rather, the city-region must be strengthened as a site of data-generation, decision-making and policy implementation (McKinsey Global Institute, 2014). For this reason, the application of the subsidiarity principle; the further strengthening of city-regional governance arrangements and cooperation across different government levels are vitally important in designing and delivering housing policies for all sectors.

Seventh, *political contestation and political leadership* will challenge the status-quo and push necessary political-administrative reforms. Current serious market and governance failures call for new partnerships similar to the 1930's New Deal in the US and the massive housing construction waves after World War II. Any intervention faces a challenging regulatory context however. Currently fashioned market supply-side interventions seem appropriate but are constrained by limited state capacity to direct private investment into affordable projects. Likewise, rent control measures are justified but always come with the risk of investors losing 'appetite', and thus diminishing supply (Jenkins, 2009). Outcomes are rather difficult to change in times where 'capitalism manages the state, rather than state managing capitalism' (Jacobs and Manzi, 2014). This grim situation is worst in the Anglophone countries where the fortunes of the political classes and the property-owning residents are ever intrinsically tied together. Where – like in New Zealand and the UK – more than half of the country's net worth lies in property, political systems are easily 'captured' and thus

reluctant to change. Transformation is about progressive politics (Jacobs and Pawson, 2015), and the competition of ideas inside parliaments and social mobilisation outside (Bradford, 2016). At stake is nothing less than the social harmony between different groups in society and between the current and next generation(s).

## 5. Conclusions: transforming housing with a private rented sector focus

Affordable and adequate housing must be delivered across all three key housing tenure types: private homeownership, private rental and social housing. Private homeownership remains important to allow young people to have a material stake in society, to avoid further concentration of capital and to promote civic participation and citizenship. Yet, it is already too often out of reach for many urban residents. There is a pressing need for more social housing, but in times of austerity, new stock is likely to be built much too slowly for the exploding demand, if it all. This paper has therefore put the spotlight on existing and potential roles of private rented systems as they have to absorb much of the immediate social and spatial crisis impacts. In prime metropolitan regions, future housing outcomes will be – at least initially – be primarily shaped in the PRS.

Much greater intellectual and policy attention needs thus to be directed to this sector and tenure. The call is for transforming private rental into a highly competitive long-term investment choice while it offers affordable, secure and adequate housing. Ultimately, this means addressing deep-seated supply problems, controlling rents and strengthening tenants' rights as well as reducing housing benefits but protecting those particularly vulnerable tenants. These challenging goals require brave political choices and new directions in policy thinking that will challenge currently dominant perspectives, beliefs and agendas; especially in a profoundly neo-liberalised Anglosphere. Notwithstanding unavoidable intervention challenges such as contrary political priorities, vexed goal contradictions, undesirable trade-offs and persistent implementation constraints, there is, nevertheless, no alternative to economically viable and socially sustainable private rented housing if we are serious about creating decent housing futures for all members in our and future generations.

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# Security rights over immovable property: An international comparison of legal provisions at a glance

↪ By Andreas Luckow

## 1. An expert committee for international comparative law

Banks offering real estate financing outside their home country have to become acquainted with the legal systems and particular forms of legal structuring in those target countries.

The most important loan collateral giving equity capital relief for banks is the security right over real property (Grundpfandrecht). Security rights over real property are even more important for Pfandbrief banks since they ultimately form the basis for the issuance of mortgage Pfandbriefe.<sup>1</sup> Ever since specialised Pfandbrief issuing banks (“Hypothekenbanken”, mortgage banks, as they were formerly known), received permission to conduct business outside Germany, the vdp has examined the adequacy of security rights over real property in other countries and the special features that should be noted in this respect.

A bank's managers and its supervisory board members are required to monitor and manage the bank's lending-related operational risks by means of appropriate procedures. The Capital Requirements Regulation (Art. 194 in conjunction with Art. 208 CRR) stipulates that banks headquartered in the European Union must ensure that security rights over real property, in order to be considered as eligible credit risk mitigation techniques, are enforceable and legally flawless and that the bank can ultimately liquidate them. This must be documented through written legal opinions which confirm, as part of the enforceability opinion, that the collateral can be promptly liquidated or retained in the event of insolvency. All lending involves risk, which has to be assessed and priced. In order to do so, the risks have

to be estimated and evaluated in each of the jurisdictions. However, the bank must also be aware of what it is capable of offering its customer. Security rights over immovable property have different levels of flexibility in each of the jurisdictions. For example, in some countries they may be used for new disbursements at the same creditor ranking, while in others they cannot, or only can be in certain instances. It is also important to know what steps are necessary in order to obtain a security right over real property, how verification of the existing legal circumstances for the property is conducted, and how long all of this can be expected to take.

The Association of German Pfandbrief Banks (vdp) brings together credit institutions that issue Pfandbriefe, the German version of covered bonds, which are subject to particularly strict regulation. These banks grant real estate loans and use the loan claims and security rights over real property for the cover pools of the mortgage Pfandbriefe. For this reason, they have always been subject to stricter requirements, so that the new requirements of banking supervisory law under the CRR are not really anything new for them.

In 1988 German law began allowing Pfandbrief-issuing banks to offer real estate financing in the countries of the European Community and to use this real estate financing as cover assets for Pfandbriefe, although at that time within narrow limits. For this reason, it became important to understand and systematically analyse the law of these jurisdictions. The vdp (at that time under its former name, VDH) took up this task as a think tank for the industry. Since 1989 the vdp has been engaged in a systematic analysis of the law of real estate loan security rights in Europe, initially in the West but from the 1990s also increasingly

in Central and Eastern European countries. Shortly thereafter analysis began of particular topics in various countries.

Through its contacts with experts in many European countries, the vdp accumulated expertise on a number of individual issues. Rather than tackling these issues on a case-by-case basis, it was decided to integrate them into a system, and in 1994 specific areas of the law were studied in a number of countries, based on questions that were standardised as far as possible.

However, as the number of countries studied by vdp members rose, so, too, did the need to be able to compare the information on security rights over real property in various jurisdictions and to make direct comparisons. This can only be accomplished with the requisite quality if experts from the relevant jurisdictions collaborate and provide the answers applicable to their own country. For this reason, in 2005 the vdp began to invite experts from 12 countries initially to exchange views and define the issues and individual questions in such a way that all questions could have a meaningful answer and also be understood in the same way. In 2010, when Otmar Stoecker reported on the project in Housing Finance International of autumn 2010, 24 jurisdictions were already involved.

Since 2005, experts from 37 jurisdictions have participated in two workshops each year, resulting in the development of 152, geographical overviews or charts showing the different countries, each containing one question. They have also developed standardised answers for all the jurisdictions, enabling a comparison to be drawn between the key features of real estate security rights in each case. In addition, there are almost 70 overviews/charts on specific issues relating to rights equivalent to real property,

<sup>1</sup> Pfandbriefe are the traditional German covered bond issued by Pfandbrief banks collateralized by mortgages kept on-balance by Pfandbrief banks.

where special attention needs to be paid to the relationship between the owner and the holder of the right (in the case of building rights) and between joint owners (in the case of apartment property). Further overviews on the features of using special-purpose vehicles (SPVs) and on protection against enforcement in the case of owner-occupied dwellings are under development. So far, the Round Table has produced more than 250 overviews and updated them on a regular basis.

For each topic, one question is developed with up to eight response options. This is then discussed extensively among all the participants, thereby enabling all the experts from each jurisdiction to select one of these answers. The result (questions and answers) is therefore relatively short and, by design, clear, although this can be achieved only if extremely high standards are set for the discussion. The method usually consists of posing questions about particular legal functions, and generally avoids registering doctrinal differences in the participating jurisdictions. Having questions emerge in a discussion involving all the jurisdictions covered is also designed to reveal the participants' patterns of thought and balance them out, leading to a neutral position as required for comparative law purposes.

Round Table experts meet high standards. In their own country, they have to be thoroughly familiar with the legal issues raised by security rights over real property, as well as with the latest case-law and academic discussion. They have to be willing to meet for workshops at least twice a year, to keep their answers up to date between meetings by exchanging information with colleagues, and to report to these colleagues on legal developments. Because the experts have so much to gain from these discussions, the vdp has been able to bring together leading minds from nearly all European countries and, in addition, from Japan, two U.S. states, and one Canadian province.

The Round Table has also had particularly good experience in getting a wide mix of participant perspectives from the various jurisdictions. As indicated above, many work as lawyers in real estate firms or in real estate financing, others as bank lawyers, notaries or academics.

Most jurisdictions recognise several forms of security rights over real property through statutory provisions or in legal practice. In all cases, the answers relate to only one form of security rights over real property for each jurisdiction. This is the form that is most flexible in practice in each case, not necessarily the one that is

encountered most often. It should nevertheless be one that is used in practice with some representative frequency. It is not possible here to break down the answers for each of the jurisdictions. This is also true where a country has special regional features, as in Switzerland. Although only one answer can be given, the IT-supported system does provide for commentary in order to offer any relevant distinctions.

## 2. Some results

The following examples are intended to demonstrate a cross-section of the study, while also demonstrating the practical relevance of the questions posed.

### 2.1. Questions relating to land register entries

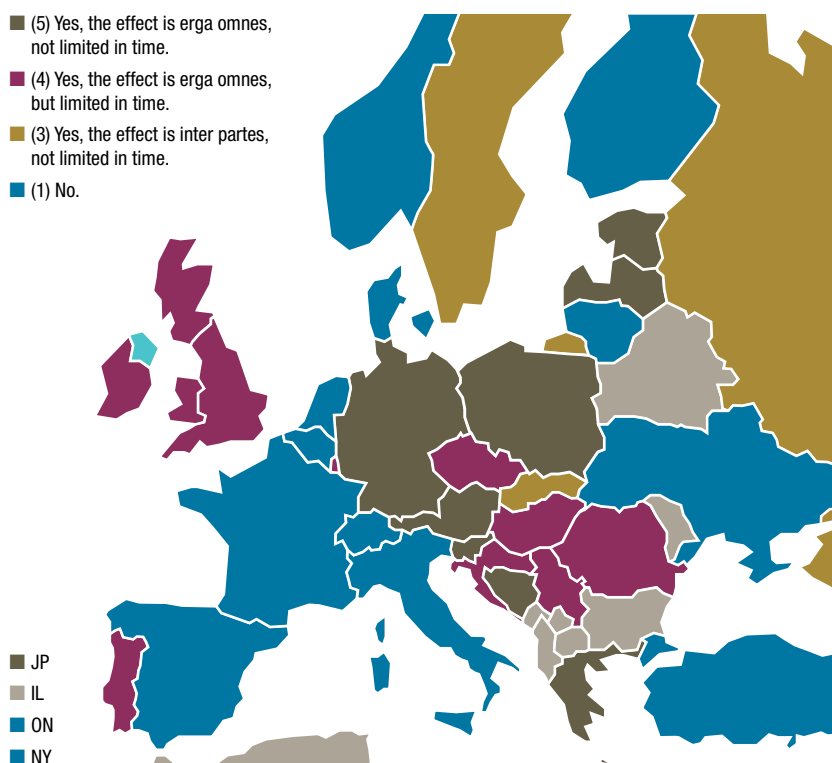
Of special importance for all participants is that legal relationships can at all times be established, verified, and guaranteed by consulting land registers. In Europe this is assured almost universally through public registers, although with significant differences between jurisdictions. While the Round Table naturally enquires

into these matters, it also poses some questions that are important in practical terms. Since property transactions are often complex, involve a number of parties, and can be lengthy, it is important in practice to enable applications for registration to be made public at an early stage and obtain legal force and effect. These issues are analysed in the chart displayed (figure 1).

The chart shows different methods for obtaining preliminary effects, as well as the countries that have no provision for this. In some of these countries, entries in the land register can be made particularly quickly (see below, exhibit 3 – chart II.16). Consequently, there is less need to ensure priority at an early stage. However, quick entry in a given case does not solve the problem associated with the step-by-step processing of complex transactions.

One of the core questions in the transaction systems of the various jurisdictions is how to verify that the grantor of a right has consented to its registration. In some cases, the main factor here is reliability, with verification limited to notarial documents, while in others, it is simplification of the procedure (figure 2).

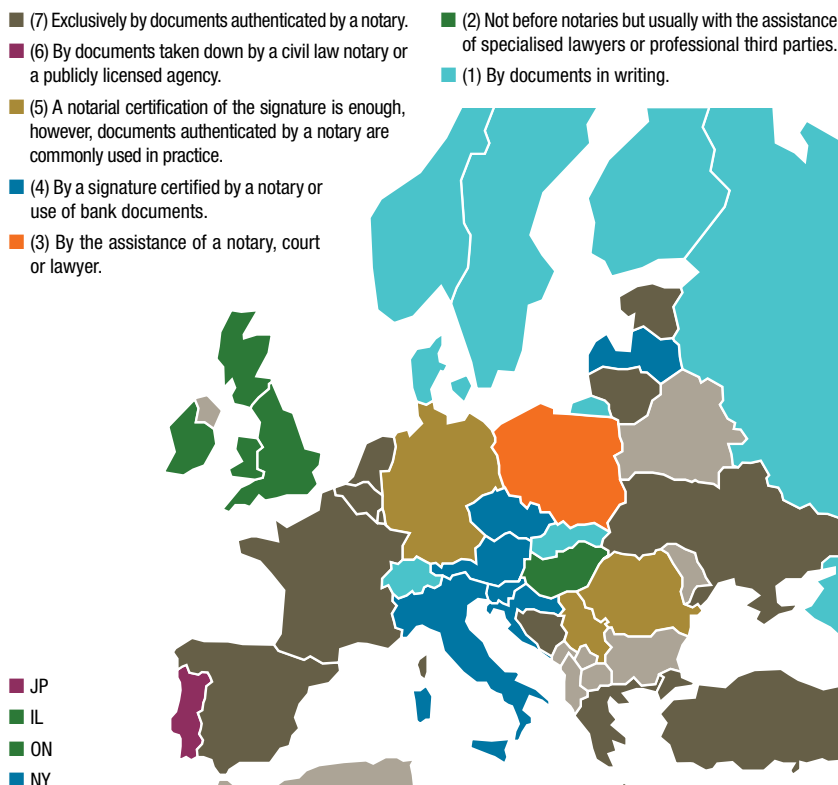
**Figure 1** chart II.7 – Is it possible to safeguard the ranking of a security right over immovable property before this right is registered (and even if it is not eventually registered)?



Source: vdp



**Figure 2 chart II.8 – How is the grantor's consent to registration verified?**



Source: vdp

Some charts depart from the field of legal questions when looking into practical effects and enquire instead about the duration of specific procedures. An argument against these types of question is that it is nearly impossible to determine this precisely using statistics, as they usually do not reflect the special aspects of any particular case. The answers can only reproduce the estimate made by the experts.

Because the question about the duration of the procedure is so important for the overall perception of a land registration system, however, it cannot be simply overlooked. The best regulations are of no use if they cannot be implemented within acceptable time limits. Moreover, it can be agreed that the question should refer only to the period required for registration where applications are made correctly and in full. These sorts of qualifications are not made in the few statistics available in this regard. Therefore, estimates by experts can be recorded for this purpose, based on practical experience and enquiries.

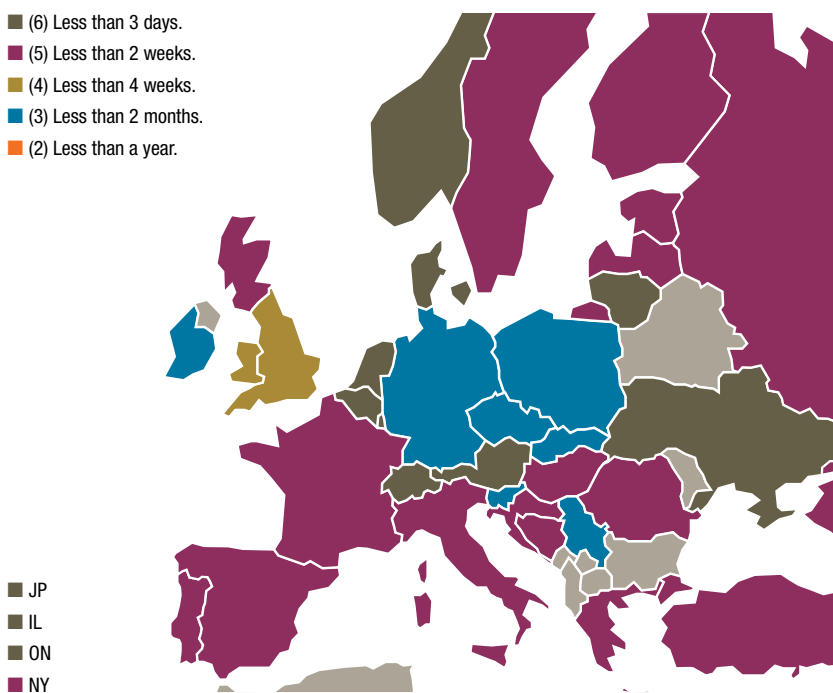
## 2.2. Reliance in connection with legal relations

With regard to registration systems, the Round Table's questions also deal with an issue that is important for practical purposes, namely the extent to which reliance on entries in the land register is legally protected. This is what determines the risk to which the parties are exposed and the effort and cost associated with establishing the facts. The extent to which reliance is protected for the holder of a security right over real property is recorded for three situations. These cover the cases where:

- the existence of the security right over real property does not correspond to the contents of the register, i.e. for unknown reasons it does not exist at all (figure 4).
- the owner and creator of the security right was not entitled to create the security right because he was not the owner, but such ownership was relied upon when creating the security right over real property (figure 5).
- the security right over real property already existed and was acquired through assignment, but the transferring party did not in fact have any right to do so, despite being entered in the land register as the holder (figure 6).

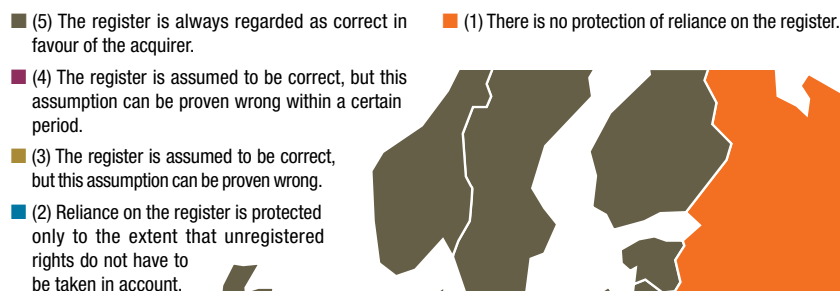
Other cases are conceivable in which reliance may be protected differently (e.g. reliance on the power of representation). However, the Round Table records the material relating to these questions in categorical terms. A comparison shows that it is not possible to make a clear distinction between countries that do and do not protect reliance on the register. What

**Figure 3 chart II.16 – If registration of a security right over immovable property is applied for with all necessary documentation, how long does registration usually take?**



Source: vdp

**Figure 4 chart II.19 – Is the reliance of the transferee of a security right over immovable property on the contents of the register legally protected?**



Source: vdp

is apparent is that several countries offer no protection whatsoever for such reliance and that others, primarily in Central Europe, afford high priority to the protection of legal relations. In yet other countries, reliance on the acquisition of title often enjoys stronger protection than the acquisition of a security right over real property, and this reliance on information about the owner enjoys stronger protection than that about the holder of the security right over real property.

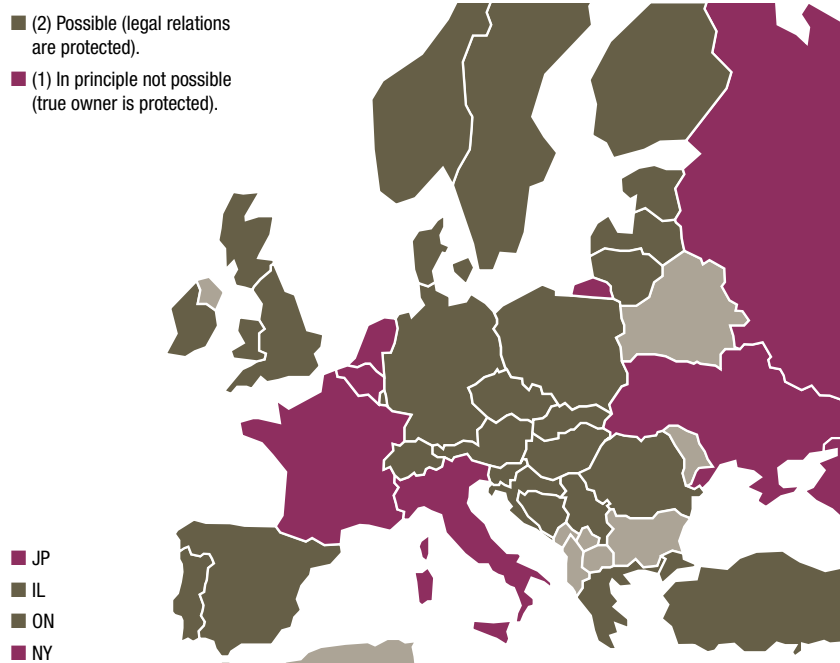
## 2.3. Security framework and flexibility

The question about the flexibility of security rights over real property was the point of departure for the Round Table and is dealt with extensively. It is worth noting here a comparison of a question of doctrinal nature, one which has a considerable influence on the practical aspects of dealing with security rights over real property. In Germany it is usually assumed that the security agreement (Sicherungsvertrag) is a feature specific to German law, which has been developed over decades by case-law and practice and has only recently been addressed by statute. It arose from use of the land charge (Grundschild). A comparison shows, however, that at least half of the countries studied use an agreement to allocate the security right over real property to associated claims. However, this does not apply with regard to each and every security right over real property but with regard to the flexible forms with relaxed accessoriness<sup>2</sup> that Round Table experts examined, such as the “maximum amount hypothec”, a type of security right over immovable property where the allocation of claims is fixed in principle but made free for all claims up to the face amount of the security right (figure 7).

The question of how linking the security right over real property with the claim works in practice and how it can also be structured flexibly is a major theme of the Round Table. In this article, this will be shown using an illustrative-only situation: the secured claims have been amortized, but now the owner and the creditor of the security right over real property wish to use it again for other claims.

Some countries do not allow this re-use at all; others do, in cases where the legal relationship was structured such that it did not extinguish when the previously secured claim was satisfied. Quite a number of countries achieve it by dispensing with accessoriness or in other doctrinal ways so as to enable re-use of the security right over real property (figure 8).

**Figure 5 chart II.20 – Is the creation of a security right over immovable property effective if done by a mortgagor who is registered as owner but is not the true owner?**

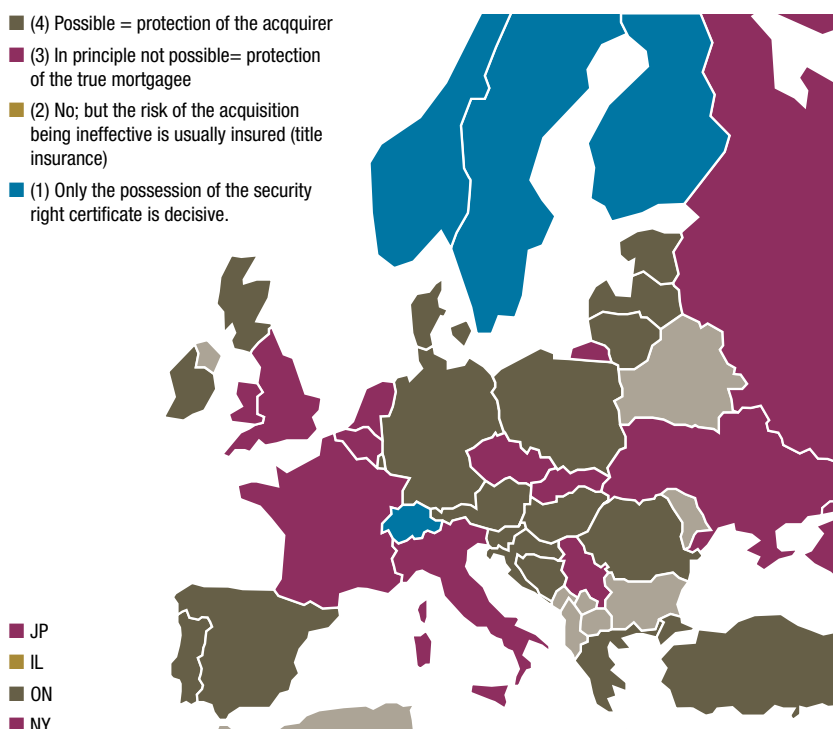


Source: vdp

<sup>2</sup> Accessoriness means the fixed and exclusive allocation of a security right over real property to an associated claim.

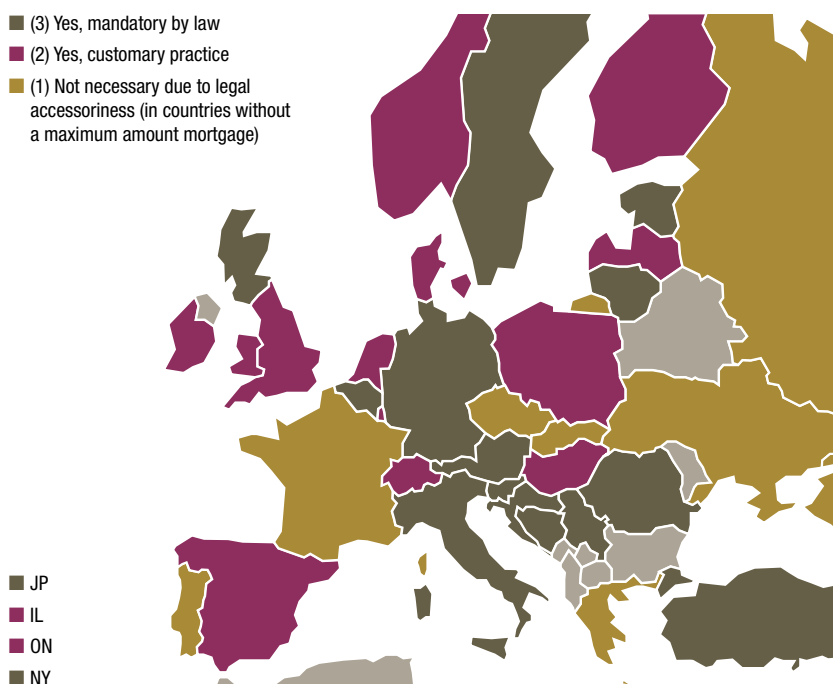


**Figure 6** chart II.2 – Is the transfer of a security right over immovable property substantively effective if done by a registered mortgagee who is not the true mortgagee?



Source: vdp

**Figure 7** chart III.6 – Is the security right over immovable property tied to the secured claim by a security agreement on the scope of the secured claims?



Source: vdp

## 2.4. Enforcement and insolvency

In the vast majority of cases, security rights over immovable property in all of the countries participating in the Round Table are handled by agreement between the parties, with the secured claims being satisfied and the security rights over real property then being extinguished without any dispute arising. Nonetheless, the question of whether a security right over real property has an economic value depends on whether it can be realised through enforcement by the holder in the event that they need the collateral to satisfy their claim. Likewise, the collateral should be able to be liquidated if the owner becomes insolvent. The details in each country are governed by different procedures. For this reason, it comes as no surprise that the Round Table has to devote a particularly high number of charts to enforcement and insolvency.

It is apparent that the various jurisdictions have developed very different methods in their legislation and, even more so, in practical application. This begins with questioning the very basis for enforcement. For German practitioners, such basis is generally an executory title created through a notarial deed. In many countries, however, a title is not required, while in others there are various ways of obtaining one (figure 9).

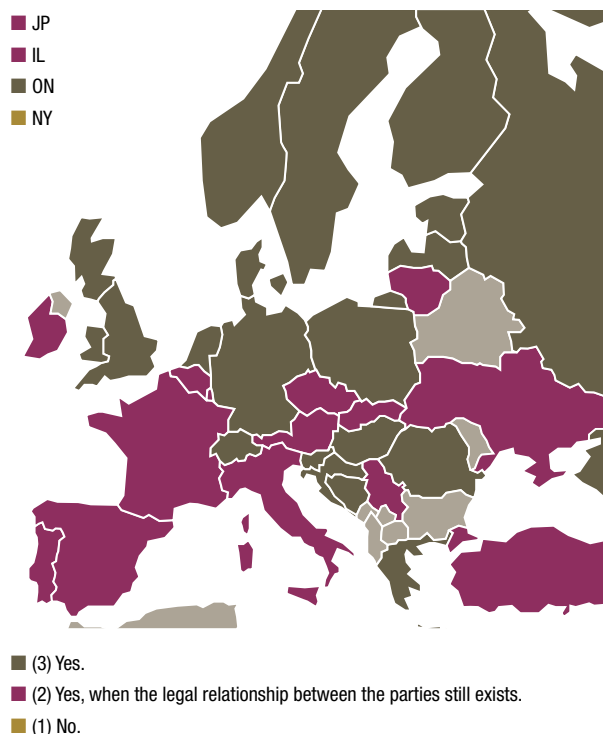
As regards ways of liquidating a property encumbered by a security right, these consist of two fundamentally different methods: auction through a publicly commissioned authority and private sale, which can also be accomplished through an auction. Some countries permit both options. The question of who has the right to decide this matter is regulated differently (figure 10).

The studies also address the status of third parties. A creditor with access to the security right over real property generally has little interest in subordinate creditors or third parties with claims against the owner also seeking to attach the property. For third parties, however, the property itself, along with its economic value, is often crucial to any realistic chance of enforcing their claim. As a result, the Round Table also has to consider the status of third parties.

It is evident that, almost everywhere, lower-ranking creditors can initiate enforcement proceedings separately (figure 11).

There are major differences, however, concerning the question as to whether it is possible to obtain a senior position in the proceedings by discharging the claims of higher-ranking creditors (figure 12).

**Figure 8 chart VI.3 – Is it possible to replace the existing secured claim with another claim against the current debtor – without affecting or changing the security right over immovable property? (the new claim immediately replacing the old one – e.g. novation, subrogation)**



Source: vdp

**Figure 9 chart IV.1 – How is the right to enforce the mortgage obtained?**



Source: vdp

The final problem to be addressed is currently being discussed in some countries, namely selling properties below their value during liquidation. This topic has its own geographical chart (figure 13).

A program was developed to create these charts. This enables users to view at any time all of the questions and answers, the explanatory notes to the questions, and the often detailed commentaries to the answers. The experts can keep their answers and commentaries up to date at all times. Third parties obtain access by paying a fee. In this way, users can gain a quick comparative overview of security rights over real property in a particular jurisdiction.

### 3. Assessment of the questions and answers

By pooling all the information from participating jurisdictions, an overview can be provided for one specific question on each issue.

The information is then further refined for this purpose. In an assessment system, a score is awarded to each question according to its importance and to each answer for its quality. By combining these scores into a total figure, a comparison can be made as to how various security rights over real property are structured at a national level. The system is easily comprehensible and verifiable.

The nature of arrangements is assessed differently depending on the perspective adopted for a particular question. For example, the best situation from a bank's viewpoint may be one where it can conduct enforcement as quickly and efficiently as possible. For a consumer or an owner of commercial real estate, it is likely to be more important for him to be protected against any all-too-quick or even unjustified enforcement and to have legal remedies against the loss of his property.

For this reason, all questions and answers are weighted not just once, but from four perspectives:

1. Enforcement of the security right over real property
2. Protection of the owner
3. Flexible use of the security right over real property
4. Viewpoint of the legislator

In the workshops of the Round Table "Security Rights over Real Property", a score was allocated for each question, each answer, and all four perspectives. If the Round Table changes a question or answer, the scores are then reviewed.

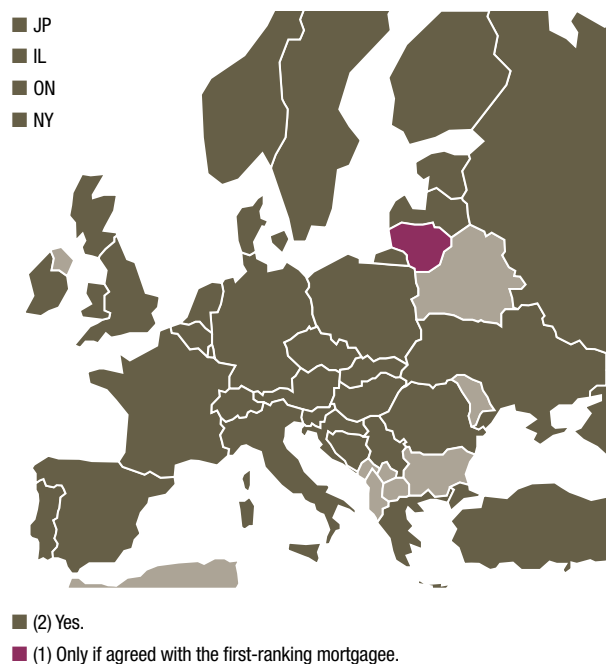
Care is taken to ensure that the definition of the content and its assessment are carried out separately. It is also ensured that the weighting of the questions is kept separate from that of the quality of the answers. The importance of a question is expressed in a score from 0 to 5. If a question receives a score of 0, this may be because it has no impact on the given perspective, but it could still be highly important from

**Figure 10 chart IV.8 – Which other options for enforcement are provided by law?**



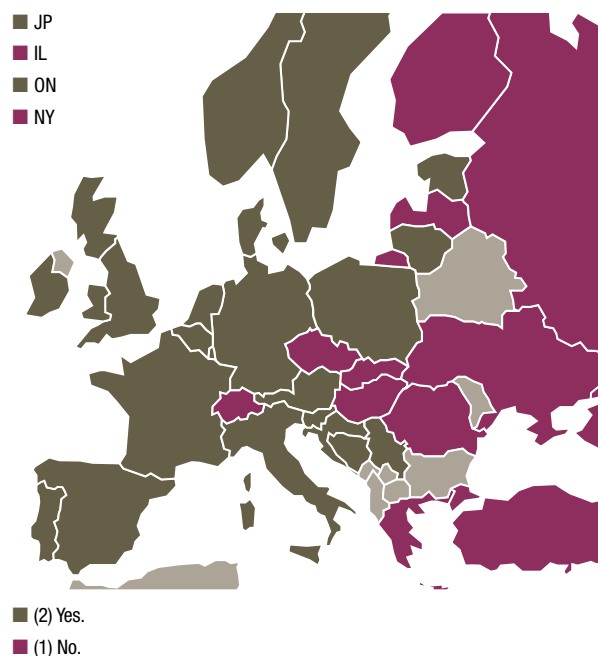
Source: vdp

**Figure 11 chart II.6 – Can lower ranking (junior) mortgagees separately initiate enforcement of the mortgage?**



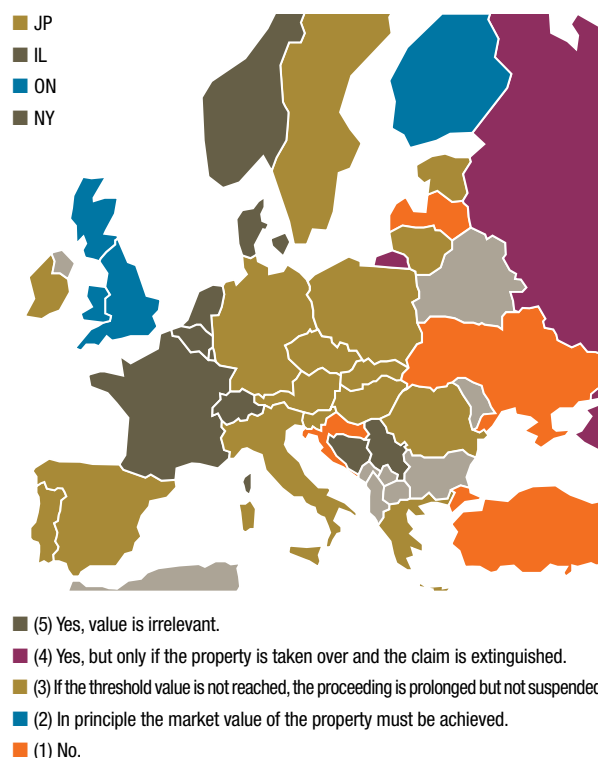
Source: vdp

**Figure 12 chart II.7 – During enforcement proceedings, can lower ranking (junior) mortgagees obtain the position of the first-ranking mortgagee without his consent or the consent of the owner by paying him out? (and get ahead of intermediate secured creditors)**



Source: vdp

**Figure 13 chart IV.18 – May a forced sale be concluded even if the price achieved for the property is below a certain threshold value?**



Source: vdp

another perspective. It may also be of high systematic interest for an overall understanding but have only minimal impact on its own.

When the score for the importance of each question (from 0 to 5) is multiplied by the assessment of the answer (from 0 to 10) and the figures relating to a country are added for all questions, this produces four figures that permit an appraisal of the quality of the legal provisions for the assessed type of security right over real property.

In so doing, it is also ensured that the weighting of the various sets of questions addressed by the Round Table is stable. For example, the charts on the rather basic questions of legal character (5 charts) are given a weighting of 1%, while the chapters are weighted as follows:

- “Public disclosure requirements” (land registry) with 26 charts is given a weighting of 25%,
- “Enforcement” with 46 charts is given a weighting of 25%
- “Insolvency” (status of the security right over real property in insolvency proceedings) with 23 charts is given a weighting of 25% and
- the two chapters “Effects of accessoriness” with 21 charts and “Utilisation in practice” with 15 charts, both looking at the question of flexibility from two viewpoints (legal effect and cases of practical utilisation), are each given a weighting of 12%, i.e. for a total of 24%.

This subdivision was introduced and established when the system was developed further in November 2015.

What are the results for each of the countries?

## 3.1. Perspective of bank/liquidation

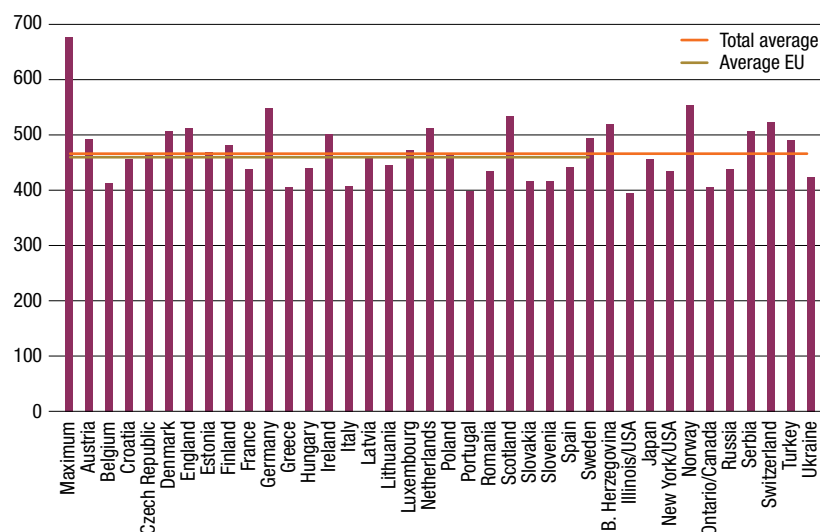
This perspective indicates what a banking supervisory body assessing the solidity of the bank or its risk management may consider to be the most important issue.

In what way does the relevant legal solution help to ensure that the holder of a security right over real property can realise his right quickly through liquidation of the property collateral and receive the proceeds in accordance with his ranking? (figure 14)

As in all of the following overviews, a maximum value (the total of all available points) is assumed. In reality this is not achievable, since it would require contradictory answers to be given in some cases. Each legal system also takes other interests into account, as recorded in the following charts. The jurisdictions are listed in alphabetical order, divided into EU Member States and other countries. The average score is marked with a

**Figure 14 Perspective of enforcement**

Results of Security Rights over Real Property in Europe at vdp  
- Complete findings - perspective of enforcement -



red line, thus enabling an evaluation to be made. A green line indicates the average for EU Member States, which is of course of particular interest for considerations about regulations at the EU level. This is relevant since the only EU Member States that are not yet represented at the Round Table “Security Rights over Real Property” are Bulgaria, Malta and Cyprus.

The comparison makes it clear that the German arrangements facilitate effective enforcement. Only the Norwegian legal system achieves higher scores, although they come at the price of a strong concentration of legal remedies. Other Scandinavian countries, such as Denmark and Sweden, are also in the top group, as are Scotland, England and Switzerland. Bosnia-Herzegovina recently opted for many legal solutions that are quite similar to Central European solutions, and it now also achieves a very high score. This is naturally of great interest to the German Foundation for International Legal Cooperation [IRZ], which, on behalf of the German Federal Ministry of Justice, has been continuously supporting the development of the legal system there, demonstrating the success of such international cooperation in legal matters.

The perspective of bank/enforcement is also of particular significance because these results are used for LGD grading (determination of the loss given default for foreign security rights over real property for the advanced ratings approach) by vdp Expertise GmbH. Together with several other factors, these results determine the extent to which banks participating in LGD grading must use equity capital for financing that is

secured by means of security rights over real property in these countries.

## 3.2. Perspective of the owner

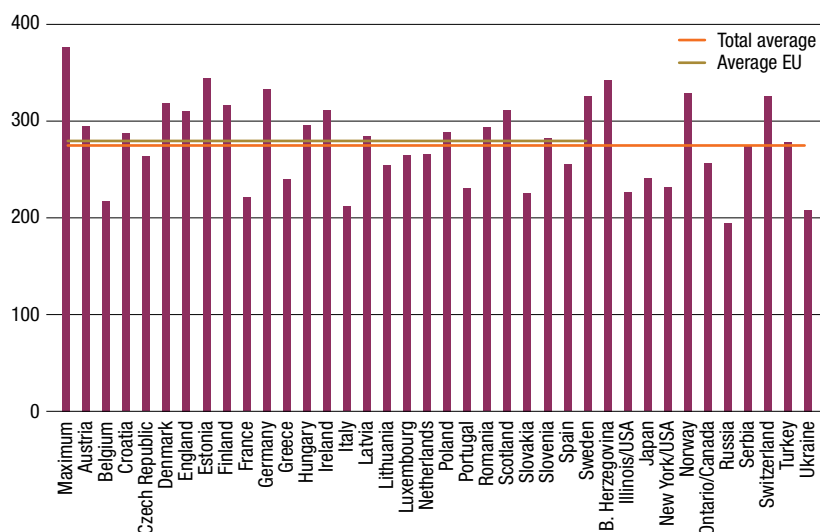
The perspective of the owner exhibits an almost opposite viewpoint. The owner is not interested in rapid liquidation. He necessarily wants his rights to remain protected at all times and for enforcement and insolvency proceedings to offer him the opportunity to exercise those rights. Shouldn't this perspective produce opposite results?

The aggregated perspective indicates otherwise. Legal systems that produced good results in terms of liquidation are in some cases also at the top end of the spectrum when considering the interests of the owner of a property encumbered with a land charge, e.g. Estonia and Germany. How can this be? On the one hand, the Round Table “Security Rights over Real Property” invariably takes into account only the exercise of justified interests. In relation to the perspective of the owner, this means the enforceability of his legal position but not the opportunities for obstruction. As shown above, the interests of the owner in the legal certainty of the land register are also a factor, as well as the options afforded to him by flexible use of the security right over real property (figure 15).

Above all, however, it is apparent that a successful reconciliation of interests is possible and that appropriate solutions can be found that offer all sides a certain degree of predictability. Questions remain in some jurisdictions, where it is simply difficult to foresee whether

**Figure 15 Perspective of the owner**

Results of Round Table Security Rights over Real Property in Europe at vdp  
- Complete findings - perspective of the owner -

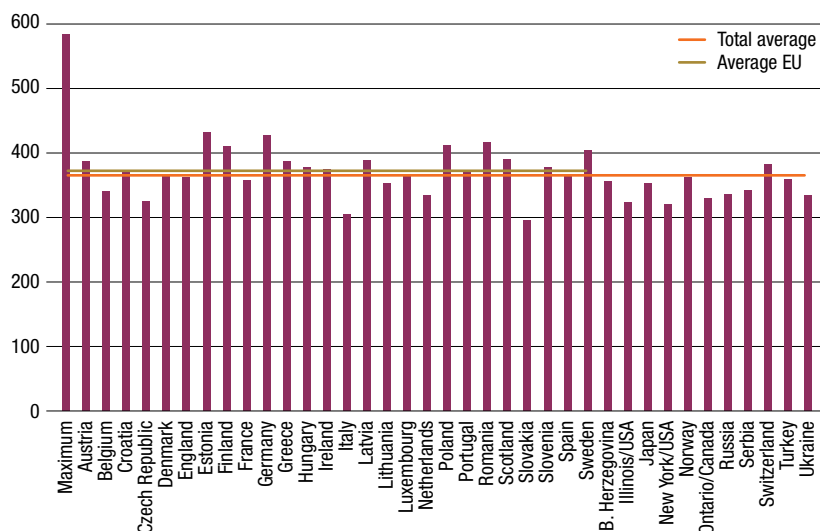


dependent. However, this perspective covers only the importance of flexibility from the viewpoint of the lender (figure 16).

The chart demonstrates that there are advantages to “non-accessory” security rights over real property. These rights provide for the separation of the loan claim from the security right over real property and link these two legal relationships through a modifiable collateral agreement drawn up by the bank and the owner. Estonia and Bosnia-Herzegovina rank even higher than Germany, both countries having adopted the concept of the land charge. The Swiss mortgage certificate (Schuldbrief) is also in the top tier, as are the security right over real property used for commercial financing in Norway and the Danish ejerpantebrev. All of these methods recognise accessoriness that is modifiable by contract. The need for these kinds of solutions is demonstrated by developments in France, where a reusable and partially transferable form of mortgage was introduced in 2006, the hypothèque rechargeable. Although it was abolished temporarily in 2013, it was re-introduced in 2015 for the commercial sector. However, this form is disregarded in the charts of the Round Table “Security Rights over Real Property” as it is still fairly uncommon. The various models of security rights over real property with contractual accessoriness nevertheless show that the objective of flexibility is achieved in several different doctrinal ways (in Germany, Estonia, and Bosnia-Herzegovina, a non-accessory security right over real property with an in-rem claim, linked through a collateral agreement with the contractual claim; in Switzerland, Denmark and Norway, a securities claim, linked contractually with the loan claim; in France, a formally accessory mortgage with a special right to swap the claim), without the assessment system of the Round Table “Security Rights over Real Property” preferring any particular method.

**Figure 16 Perspective of usability**

Results of Round Table Security Rights over Real Property in Europe at vdp  
- Complete findings - perspective of the owner -



the interests of both sides are safeguarded. This cannot lead to good scores from any perspective.

It is also interesting that, from the owner's perspective, the average of the EU countries is further above that of all participating jurisdictions than is the case from the other perspectives. Perhaps this indicates a somewhat higher quality of legal provisions overall.

### 3.3. Perspective of bank/usability

The issue here is the extent to which the respective solutions enable a security right over real property to be used flexibly for a variety of claims. This can save considerable time and cost for the bank and the owner, as well as facilitate the development of new financing methods. It is also of great importance for the owner, on whose consent any flexible use is normally

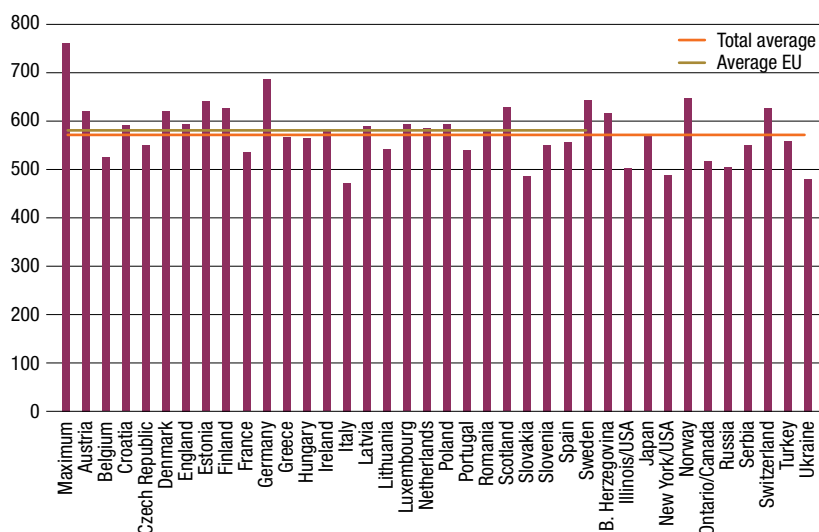
### 3.4. Perspective of the legislator

The legislator is not permitted to give preference to the interests of any one of the parties involved. It must also take into consideration that lower-ranking and unsecured creditors may also have an interest in satisfaction from the property, which must be protected as appropriate. The interests of the bank and the owner are therefore included in the perspective of the legislator, together with the interests of these third parties. The perspective provides an assessment as to whether the legal solution offers an appropriate reconciliation of interests (figure 17).



**Figure 17 Perspective of the legislator**

Results of Round Table Security Rights over Real Property in Europe at vdp  
- Complete findings - perspective of the legislator -



## 3.5. Total scores

If four figures for one jurisdiction are found to be excessive, then the bar chart with the summation of all scores from the other four charts may be preferable. This presents an overall figure for each jurisdiction. The land charge in the German legal system is at the top in this case. It offers advantages in many respects (figure 18).

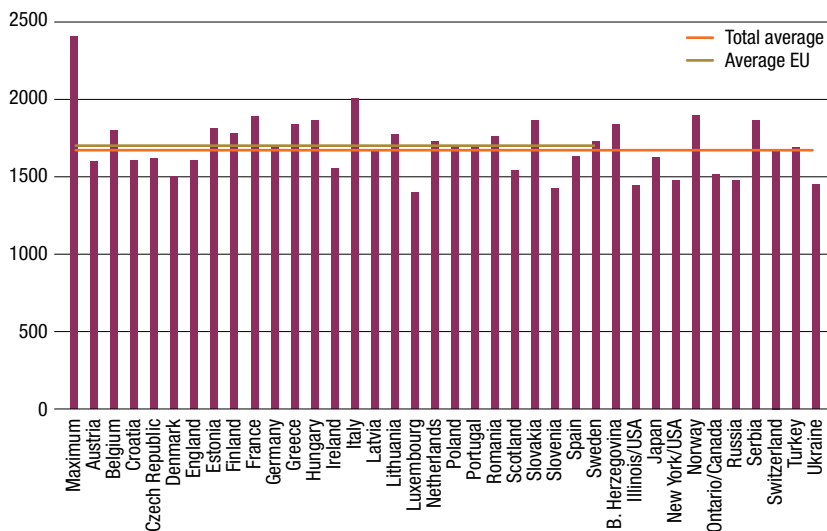
The charts summarise the extensive results of the Round Table “Security Rights over Real Property” in clear overviews, offering quick and comprehensible results. With regard to the quantification of legal issues, there are only a few other systems that achieve a similar level in terms of substantive depth and a simple presentation in summary form. For this reason, the Round Table’s bar charts are always given special attention during discussions. They are available to the experts in the Round Table “Security Rights over Real Property”, and they use them in their scholarship and in their home countries. They are also a useful tool for the international business conducted by credit institutions. The results have not only been used by the member banks of the vdp for real estate financing purposes but also by government ministries in a number of countries and by the EU Commission. The results relating to capability of liquidation and usability are used for LGD grading. For example, vdp Expertise GmbH, a subsidiary of the vdp, calculates the loss given default [LGD] for those countries in which adequate historical figures on default rates for mortgage loans are not available. The LGD is used for the capital backing of the security rights over real property.

Since the autumn of 2014, the regular reports of the Round Table experts on legal developments in their countries are also made available twice a year to banks requesting them. The reports are used for the legal monitoring of mortgage collateral in those countries required under the CRR (Arts. 198 and 204, see above). In this way, too, the information flows directly into banking practice.

As a result, the findings from a large group of leading experts are made directly usable. vdp Expertise GmbH, a subsidiary of vdp, is ready to give access to the system for a small fee.

**Figure 18 Total scores**

Results of Round Table Security Rights over Real Property in Europe at vdp  
- Complete findings - total addition of all scores -



# Book Review

*Milestones in European Housing Finance*; edited by Jens Lunde and Christine Whitehead,  
Published by John Wiley and Sons Ltd, 2016 at £85.00.

↪ Reviewed by Peter Williams

This edited volume with a foreword by Professor David Miles, a distinguished UK economist and former member of the Bank of England Monetary Policy Committee, is an important new contribution to the housing finance and economics literature and not least in a comparative perspective. It was published in January as part of the RICS Real Estate Issues series and is edited by Jens Lunde and Christine Whitehead, two longstanding and distinguished academic authors in this area.

The book is the product of work from within the European Network of Housing Research [ENHR] working group on housing finance. The group was set up in 1989/90 and jointly chaired by Bengt Turner and Christine Whitehead. In 1993 they edited a volume on housing finance in the 1990s and the exercise of monitoring and analysing developments in the European housing finance market has continued since then. Bengt sadly died in 2007 but Jens Lunde has joined with Christine Whitehead to edit this latest volume. It is a considerable tour de force, highlighting the very productive role of this ENHR group over the years.

The book aims to be a celebration of 25 years of the group and some 42 authors have contributed to the 25 chapters. 21 chapters cover single countries – Australia (Yates and Yanotti), Austria (Mundt and Springler), Belgium (Winters and den Broeck), the Czech Republic (Sunega and Lux), Denmark (Lunde), England (Scanlon and Adamczuk), Finland (Tähtinen and Laanti), France (Tutin and Vorms), Germany (Kofner), Hungary (Hegedüs and Somogyi), Iceland (Eliasson and Skúlason), Ireland (Kenna), the Netherlands (Elsinga, Priemus and Boelhouwer), Norway (Barlindhaug), Poland (Widlak and Laszek), Portugal (Xerez and Fonseca), Russia (Plotnikova, Tumanov and Zhelezova), Slovenia (Cirman and Sendi), Spain (Pena and Alberdi), Sweden (England) and Turkey (Coşkun). There are then four overview chapters – The Introduction and European Housing Finance Models in 1989 and 2014 by the editors, Milestones in EU Housing

and Mortgage Markets (by Jennifer Johnson and colleagues at the European Mortgage Federation/Centre for European Policy Studies) and finally the concluding chapter by Lunde and Whitehead titled 'Following on from a quarter of a century of mortgage debt'.

Each country chapter aims to set out the milestones in the development of the housing finance market in that country over the last twenty-five years and broadly the structure is the same in each contribution although obviously the content varies, not least reflecting the role played by government and regulation. Each author seeks to track and comment on developments and to take a view on possible future trends. 18 of the countries are firmly in Europe but Russia and Turkey are included, as their systems are partially European and Australia is in because it shares many characteristics with England. As the editors note, there are probably five distinct types of finance markets across Europe – the Anglo-Saxon (England/Ireland), the Scandinavian (Denmark, Finland, Iceland, Norway and Sweden but also France and Belgium to a lesser degree), the Central European corporatist systems (Czech Republic, Hungary, Poland, Russia and Slovenia) and Southern European countries (Portugal, Spain and Turkey).

It is not possible here to review in detail all 25 chapters and it is probably unlikely that most readers will use the book other than in a selective way. In that regard the focus here is on the overview chapters. Each of the country contributions is interesting, highlighting for this reader the extent to which many countries have faced similar problems around access to finance and have tried similar solutions with varying levels of success. Equally there are innovations and without doubt one role this book can play is as a sourcebook of innovation. Most things have been tried somewhere! Moreover, the country contributions typically allow one real insight into the mechanisms used, giving a degree of detail which is often lacking. Yes, the problems of 'translation' remain in that the reader will then

impose their own assumptions on that reading but it is progress.

The editors rightly remind us in the introduction that the 25 years under consideration include the global financial crisis [GFC] of 2008 in which the expansion and deregulation of housing finance played a particular role and where there was clear evidence of a contagion effect. Somewhat ironically, prior to 2007/8, housing finance had been held up as a model of deregulation and privatisation as many countries moved to reform and open up their mortgage markets and to reduce the role of the state. The collection delivers considerable insight into how this process of expansion and then collapse played out in each country and there are considerable variations. However, common to many countries was the significant increase in house prices fuelled by the expansion of mortgage credit. Similarly, over the period we have typically seen a contraction in the role of government and in special protected circuits of housing finance and an expansion of market provision often supported by international financial flows.

The editors argue this liberalisation and to some extent internationalisation has resulted in more efficient housing finance systems and ones which gave greater market access to more people – opening up home ownership and supporting an expansion of this tenure. In some cases, this proved unsustainable with a combination of price and affordability pressures along with market contraction, not least post the GFC, leading to a subsequent contraction in home ownership. The editors provide a useful statistical overview of trends across the different countries and conclude that over the period there has been some narrowing of the differences in the finance systems operating in Europe.

The second chapter is built around a questionnaire survey sent to each of the national experts asking them to compare their systems in 1989 and 2014. The results allow us to quickly to see how the landscape has shifted over the period

– less reliance on the state and family support, more use of mortgage loans, with longer loan terms and reduced down-payment requirements. Falling inflation has meant loan debt has only slowly reduced. In terms of funding systems, retail deposit based systems have been reduced and replaced by more diversified capital market structures with covered bonds now in place in 18 of the 21 countries (and legislation exists in 26 out of 28 EU member states). In terms of credit assessment, lending restrictions and loan terms, these have become more standardised, partly reflecting the growth of EU legislation. Indeed, the editors conclude that the evidence from the survey is that there has been ‘considerable convergence in how mortgage markets operate’.

A quick scan of Chapter 24 on milestones in EU housing and mortgage markets sets out the chronology and substance of how housing finance within the EU has evolved. This is a helpful summary. It tracks through market developments in the context of a doubling of mortgage volumes over the 25 years, aided by low inflation, market consolidation and economic growth (and the expansion of secondary markets via for example covered bonds). The authors highlight the role of the Commission in pushing forward new standards in securitisation post the GFC and in promoting the current rounds of activity on mortgage regulation.

The last chapter in the collection is a reflection by the editors on what has or has not changed

– assisted by reviewing their 1989 and 2014 surveys. They suggest that possibly the most important change has been the shifts in funding methods from retail deposits to the use of capital markets even though the latter were found wanting in the GFC. In reviewing the impacts of the GFC, the editors suggest there were 7 countries which were relatively unaffected – Austria, Belgium, the Czech Republic, France, Germany, Norway and Sweden along with Australia, Finland and Turkey where the impact was greater but recovery was quicker, in part through government action. The remaining 11 were much more affected and three of these Iceland, Ireland and Spain (plus probably Portugal) were seen to still a long way from returning to normality.

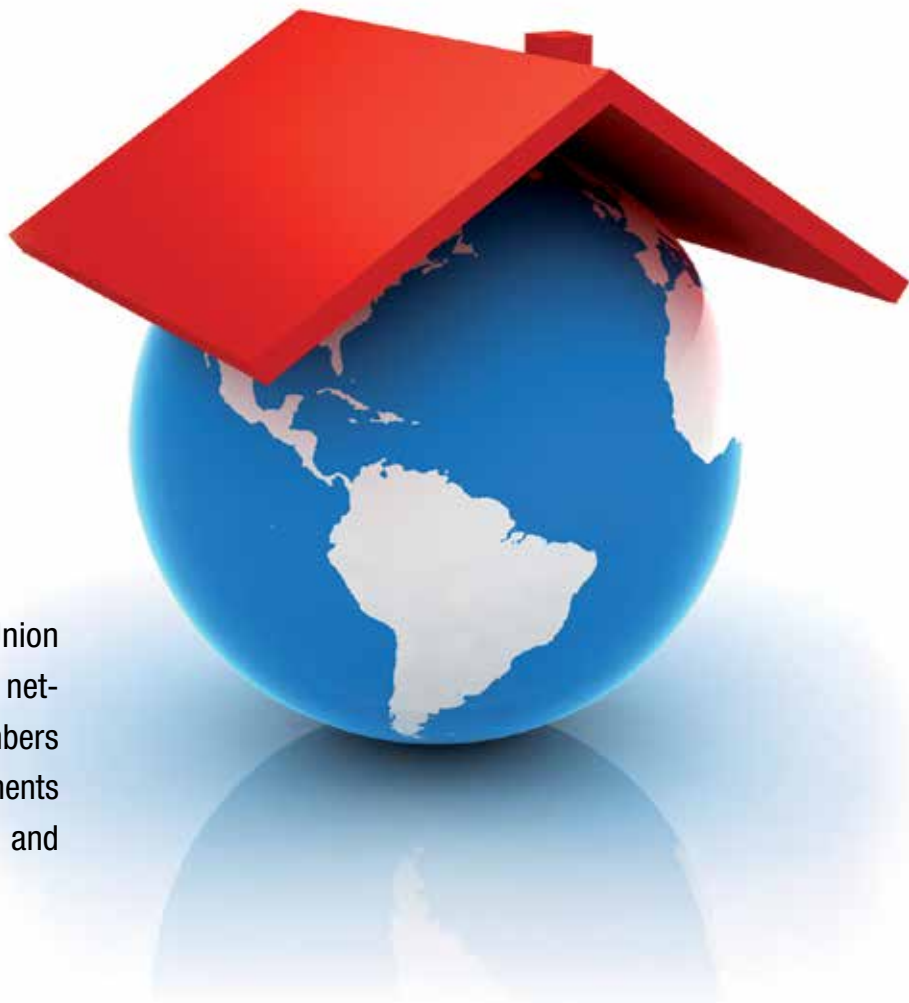
Summing up the 25 years the editors offer up the analogy of the ‘game of two halves’ – expansion and liberalisation followed by crisis/adjustment and regulation. They recognise the challenge is to build resilient systems and they question how much progress has been made in terms of this. They rightly highlight the question of what happens when interest rates start to rise on a sustained basis. Lunde and Whitehead suggest that despite the risks it is possible we will see a new era of liberalisation over the longer term, even though more regulation may dominate in the short term.

Without doubt this is a valuable new book which goes some way to help fill the substantial gaps in

our comparative understanding of housing finance systems. For reasons we will all understand most books and reports focus on a single country or perhaps a small selection of countries and few focus mainly on housing finance. Even here we are only dealing with Europe (plus Australia) and then the book does not include Italy, Luxembourg, Switzerland, the rest of the UK and a substantial part of Eastern Europe. Nonetheless it is both as up to date as one might expect and it offers a time dimension allowing the reader to understand the scale and dynamics of change.

The editors and indeed the Working Group are to be congratulated on this book. It is not without its flaws and the very scale of the enterprise has clearly posed a challenge to the editors in extracting key themes. Despite the importance of housing finance, both the market and the industry tend to be pre-occupied with the here and now. Too little time is spent taking the longer and wider view and with all the consequences we are aware of. The engagement of regulators and central banks in questions around the functioning of the housing finance and mortgage markets is one consequence of the 25 years under discussion here. Housing is now a far more important feature of the macro-economy than it was before and it does now mean it has begun to get the scrutiny it deserves. Of course there is a downside to that in terms of the scale and detail of the interventions that follow. But given the importance of the finance and housing markets is there really any alternative?





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