Comparative Analysis of Mortgage/Housing Finance Systems

Introduction

A housing finance system refers to the mechanisms, instruments and policies through which financial resources from both the public and private sectors are mobilized and channeled into housing development. The housing finance system is somewhat different from the general system of financing because of the peculiar characteristics of housing. Mortgage Financing remains the de-facto form of housing finance all over the world. This is because a mortgage is about the only avenue that affords most households the opportunity of financing an asset 4 to 10 times their annual income.

In high-income economies, mortgages are widely available and routinely used for financing of housing. However, the same is not the case in many low and lower-middle-income countries, judging by a global standard - the total mortgage debt as a percentage of the GDP. As an example, ratio of mortgage debt to GDP is 83%, 62% and 53% in Netherland, UK and US respectively, whereas it amounts to less than 1 percent of GDP across most developing countries including Pakistan, Ghana and Nigeria.

This phenomenon births some thoughtful questions. What factors are germane to the development of efficient housing finance systems? Are underdeveloped housing finance systems just a symptom of the general shallowness of financial systems across developing countries? Or are there country factors and policies that enhanced mortgage finance in economies where this system of housing finance has proved successful? It is important for developing countries to understand the factors that explain these differences so that they could design appropriate interventions to improve mortgage finance.

The Romanian Mortgage Market

The Romanian mortgage market is nascent, it came into existences in the late 1990s when the country renounced communism; the first mortgages were granted in 2001 by the National Housing Agency of Romania. This article features Romania because in spite of the economic disruption the country experienced while practicing communism, it has achieved so much within about two and a half decade. Romania's Mortgage loan to GDP was 7.6% of their $186.7bn GDP in 2016, the lowest, when compared to other countries in the European Union. This, however, is quite some achievement compared to Nigeria where mortgage loan to GDP is less than 1% in almost seven decades.

At 96% in 2016 and 96.1% in 2018, Romania has the highest homeownership rate in the European Union and probably in the world (Eurostat 2018). According to the Romanian Central Bank, the mortgage market has been growing steadily around 18% per annum. And this trend is expected to continue, albeit at a somewhat slower pace. About three decades ago, mortgages were hardly available in Romania when the country practiced communism. In the period since renouncing communism, the mortgage market, which was altogether non-existent budded, bloomed and flourished. Even when the euro crisis hit in 2009, and homes lost more than half of their value, the mortgage market recovered very quickly.

Currently, in Romania, there are 36 credit institutions of which 8 are foreign Bank Branches and 145 non-bank financial institutions that are licensed to carry out lending activities, including mortgages. Banks are the main mortgage lenders, with marginal input from non-bank financial institutions; the top 10 banks grant the majority of mortgage loans. The Romanian Mortgage market operates on a deposit-based funding structure. Deposits increased faster than non-government loans such that the LTD ratio declined from the maximum 1.3 reached in December 2008 to 0.8 in December 2016. The Loan-to-Deposit Ratio (LDR) is approximately 85%. Thus, credit institutions mainly use funds attracted from clients in order to grant loans. Credit institutions have gradually reduced their dependence on parent banks by increasing their deposits volumes.

Between 2001 and 2008, mortgage loans in Romania had a 35-year tenure and 80% – 85% LTV. In 2009, the Romanian government launched the "First Home" (Prima Casa) Program. The program is characterized by reduced margins, 95% LTV, 30 years tenure, 50% guarantee offered by the National Guarantee Fund for Small and Medium Enterprises. This program significantly boosted mortgage lending. In 2016, mortgage loans through the "first home' program was worth 7.37 billion Euro and it accounted for 57% of the outstanding mortgages. Also the rate of non-performing loans decreased 2.3 times in 2016 compared to 2014.

Romania has efficient mortgage market infrastructures including land registries with easy registration and transfer of titles, enforceable property rights and mortgage laws, which until 2016, were mostly in favour of the lenders. However, in 2016, the Romania government adopted two laws that make mortgage lenders rather nervous and are subject to legal proceedings. Firstly, Romanians can - under certain conditions - run away from their mortgage debt and saddle the bank with the house. Secondly, banks are now obliged to convert foreign currency mortgages into Romanian leu. Time would tell whether these legislations would serve to increase homeownership. It highly probable however, that it may have serious adverse effect, much like the subprime crisis in the US if appropriate checks and balances are not put in place.

Apart form the First Home Program, several other reasons account for Romania's high homeownership rate. These include affordability, demographics and provision of guarantee by the government.

Affordability: Houses are relatively cheap in Romania - the majority of the homes cost less than 60,000 euros. Also the affordability of houses increased over time, due to downward adjustment in house prices, lower interest rates and higher incomes. Households' gross disposable income grew faster than the GDP starting with 2013 and reached almost 80% of GDP in 2016 up from 60% in 2008.

Demographics: Romania has an ageing and declining population. Within two decades (1994 – 2014), the Romanian housing stock increased by slightly more than 1 million units, and during the same period, population shrank by more than 3 million inhabitants, driving the median age of population up by 7 years from 34 to 41 years. This is actual a reverse of what obtains in Nigeria. Nigeria' population is young and rapidly increasing yet, housing supply is not increasing at a rate commensurate to the growing population. The insufficient supply of housing is further exacerbated by the high house prices for borrowers and the unfavourable macroeconomic indices for the lenders.

Government Guarantees: The 'First Home' program offers starters the opportunity to take out a loan with a government guarantee. Almost half of all new mortgages issued have been granted under the scheme that came into force in 2009. The scheme also applies to Romanians who work abroad but want to buy a home in their mother country. A few years after its launch, the first home program was expanded for the purchase of another house - provided that the new house is larger and more expensive than the old one.

Innovative product design: As a collaboration between lenders and the national Hosing Agency of Romania, a rental housing program designed Young People Constructions Program addresses the needs of young people aged 18 to 35, who cannot afford to buy or rent a housing unit on the free market. The Rental Housing Units for Young People are built through the National Housing Agency. On their completion, these housing units are handed over to the local councils, which assign them to eligible young applicants. The local councils provide the lands where the housing units are built as well as the necessary utilities. The rental housing units for young people may be bought by the leaseholders (tenants) at the end of at least one-year continuous lease.

Netherland

The Netherlands is the sixth largest economy in the EU by GDP and ranks fifth in the EU for GDP per capita. The Netherlands has traditionally had an open economy with a population of about 17.1 million in 2017. The economic growth rate is 3.2% per annum and inflation is 1.2% as at 2017.

The Dutch Mortgage market

Mortgage as a ratio of GDP is 88% in the Netherlands, higher than 63% and 52% in UK and US respectively. Similar to what obtains in other countries in the EU, mortgage in the Netherlands are provided by banks and non-bank financial institutions. Prior to the euro crisis, banks were the leading mortgage providers but currently, the non-banks' market share is increasing steadily and these non-bank investors made up a third of the total €80bn annual Dutch mortgage volume in 2016.

In 2017, the Netherlands had about 7.7 million housing units, 56% of which were owner occupied and 81% of all owner-occupied residences were wholly or partly financed through mortgages. Until 2017, LTV in excess of 100% were not uncommon in Netherland. In 2017, LTV was pegged at 102% with a view to reviewing it even lower. Mortgage loans are provided predominantly on the basis of income. LTV's are less of an issue in the Netherlands due to tax incentives that make Dutch mortgages much more affordable than in other countries. Mortgage tenure is typically 30 years in Netherland regardless of the type of mortgage. There are no nationality restrictions on mortgages in the Netherlands; foreigners and even non-residents can take a mortgage only that but they will be given a stricter lending criteria.

Dutch households have a good track record in paying off their debts. Fitch (2013) ranks default probability for Dutch mortgages among the lowest in Europe. This is due to employment protection and strong unemployment benefits, strict underwriting rules and the strong legal position of lenders.

Mortgage Banking has flourished in spite of the seeming high risk constituted by the LTV and because of the strong legal position for lenders. The Dutch system offers full recourse to the borrower. Lenders can repossess and sell properties by public auction without a court order. Lenders are also provided further recourse to other wealth including salary. Any remaining debt remains enforceable until discharged in full. Moody's (2013) ranks the Netherlands high in terms of the legal right of recourse and in the practice of enforcement in comparison to other countries. Another important features of the Dutch market is that it is highly standardized and there is not that a huge difference between one lender and another. This standardization and the common use of independent mortgage brokers makes it easy for new lenders to enter into the market. Other factors that accounts for the success of the Dutch mortgage system includes:

Tax Benefit: The Netherlands has a generous tax regime for homeowners. Interest paid on mortgage loans for the main residence is fully deductible from pre-tax income for a maximum period of thirty years. Tax deductibility thus offers firm income support for homeowners. Dutch homeowners receive on average forty percent of their paid interest back as a tax benefit. This mechanism is an important driver for buyer behaviour in the Dutch housing market. Tax deductibility has fuelled demand in the owner-occupied sector, causing homeownership to grow from 48 percent in 1993, to 56 percent in 2013.

A wide variety of repayment models: The Dutch mortgage system affords citizens and residents the opportunity of a variety of flexible repayment plan as suits the customer. Repayment models includes capital repayment models (Annuities Mortgage and Linear mortgage), Interest only repayment models, life insurance repayment model, guaranteed life insurance repayment model, hybrid repayment model (see appendix).

Government Guarantee: Through the NHG (*Nationale Hypotheek Garantie*), the government provides a guarantee for mortgage repayment in case of default on the part of the borrower. The guarantee, however, is only available for mortgages up to a certain value (EUR 247,450 in 2017). The NHG ensures that in case of foreclosure, a defaulting customer will not be liable for any sum over the value of your property when it is sold, yet the lender will be repaid in full. This means that in case of default and the inevitable foreclosure, if the value of the property is lower than the mortgage the customer will not be liable for the difference. The NHG reduces the cost of lending, and lenders in turn offer NHG participants a lower interest rate, typically up to 0.7 percent lower. The application fee for the NHG is 1 percent of the mortgage value. This means that if you buy a property that costs EUR 140,000 and put EUR 40,000 down upfront, the mortgage value will be EUR 100,000 and the application fee will be EUR 1,000. Over 50% of Dutch mortgages are issued with NHG-guarantee.

Conclusion

Based on the two countries reviewed, it would not be wrong to say that efficiency of mortgage banking is not influenced by only the depth of the financial system in a country. Country specific factors including the strength of the legal system, the existence and ease of enforcement of property rights, the socio-cultural inclinations of citizens of a country equally influence the efficiency of mortgage finance in any country. Going forward, the following measures would help to deepen mortgage financing in Nigeria.

Increasing Housing Stock: The housing market, like every other market responds to the law of demand and supply. All other thing being equal, house prices will remain high and unaffordable as long as houses are scarce. Even if all other factors such as macroeconomic indices and regulation becomes conducive, if housing supply is not beefed up to keep pace with the population, housing will remain expensive and housing finance through the avenue of mortgage will remain in the purview of the rich.

Exploring other forms of repayment model: Currently mortgage repayment in Nigeria is. It might help if other forms of repayment plans are explored and inculcated in our underwriting standards.

Strengthening the Legal Environment for Mortgage transactions: Laws/regulations to provide a strong legal foundation for mortgage system of financial intermediation are non-existent. Where they are available, the weak institutional structures in the country often render them ineffective either in terms of compliance or enforcement.

Introduction of Tax Benefit: This practice considerably boosted mortgage financing in the Netherlands. Exploring the possibility of such for first time homeowners in Nigeria wont be a bad idea.

Appendix

Annuities mortgage

The defining characteristic of an **annuities mortgage** is that you pay a lot of interest in the initial years but repay little of the initial capital loan. This reverses towards the end of the mortgage term as you begin to pay off more capital and hence less interest. With the exception of fluctuations in mortgage interest rates, you make fixed monthly payments throughout the mortgage term.

Through redemption (i.e. repaying the mortgage), the mortgage debt decreases and the amount of interest you pay decreases over time**.** However, this means that your net housing costs will increase slightly as only the interest on the loan is tax deductible. In the early years of the mortgage term, the annuities mortgage results in lower monthly payments than a linear mortgage.

Linear mortgage

In a **linear mortgage**, you repay the initial mortgage loan by a fixed amount every month. On top of this you pay interest, but the interest payments will reduce over time since you are gradually redeeming the initial loan. Since the mortgage amount will actually decrease, so will your interest payments**.**

A linear mortgage can be useful for people who wish to **repay their mortgage as quickly as possible** and who are expecting a reduction in income sometime in the future. However, the initial monthly repayments are relatively high. It is also important to note that in this model, you will not be taking full advantage of the fact that mortgage interest is tax deductible.

- **Interest-only mortgage** (*aflossingsvrije hypotheek)*: in certain circumstances the bank will allow you to only pay interest on a monthly basis and to repay the capital at a later date from savings or investment accounts. If you took out an interest-only mortgage before 1 January 2013, you can deduct the interest you pay from your income for tax purposes. But if you tool the mortgage out after that date, then the interest you pay on the mortgage cannot be deducted from your income.

- **Life insurance mortgage** (*levenhypotheek*): this mortgage is linked to a life insurance policy. The client pays a monthly or an annual premium, which is often invested in a mutual fund. The premium can include life insurance cover. This policy can be tax free under certain conditions.

- **Guaranteed life insurance mortgage** (*spaarhypotheek*): This mortgage type is also linked to a life insurance policy, but with a guaranteed return. The interest you receive on your premium is equal to the interest you pay, hence you are guaranteed that your mortgage will be repaid at the end of the mortgage term. This policy can also be tax free.

- **Hybrid mortgage** (*hybride hypotheek*): A combination of the interest-only and life insurance mortgage. With this type you can switch from a mutual fund with investment risk to a guaranteed return on your money.

- **Investment account mortgage** (*beleggingshypotheek*): In an investment account mortgage you invest a certain premium into a stock market account. This premium can be a lump sum, a monthly or an annual premium.

- **Guaranteed savings account mortgage** (*bankspaarhypotheek*): This type of mortgage offers a high level of security and you will save money at a fixed rate. This rate is equal to the mortgage interest rate and at the end of the term you are guaranteed to have saved enough money to repay the mortgage loan. The interest payments remain constant at their original level which means that you are also optimising your tax break. It is also possible to invest rather than save, although there is obviously an element of risk involved in investing instead of saving.

Credit mortgage (*krediethypotheek*): This type of mortgage is a flexible loan. Like a bank account, the holder can desposit and withdraw money into it. The holder pays monthly interest on the amount that was borrowed, which depends on the value of the property.