

INTEGRATION OF EUROPEAN MORTGAGE CREDIT MARKETS

Šárka Hyblerová

Technical University of Liberec
Faculty of Economics
Studentská 2, 461 17, Liberec 1, Czech Republic
sarka.hyblerova@tul.cz

Abstract

The European Commission has been seeking to gradually integrate the European mortgage credit markets for several years; the Commission considers this activity as a priority for more efficient functioning of the European Union (EU) financial system. The reason is a relatively high volume of not repaid balances of mortgage loans on housing in the EU member countries, which represents approximately 50 % of the EU GDP. The result of these efforts was a publication of so called White Paper on the Integration of the EU Mortgage Credit Markets in 2007. This document summarizes the measures for improving efficiency and competitiveness of the EU mortgage credit markets. However, the document was discussed and consequently accepted at the time when nobody assumed the critical development in the area of mortgage credit financing and the subsequent reaction of financial markets.

Introduction

Housing construction is an important part of economic activities and investments have significance in this segment of economy from a short-term point of view and also from a perspective of a long-term economic growth. There are various possibilities of how to finance investments in housing construction and their usage differs depending on a region and specifications of the local housing policy. A mortgage credit is one of the liabilities of which characteristics suit the best to financing investments in housing construction.

Although there is a continuing gradual process of national mortgage credit markets integration into the European Union (EU), the European Commission (Commission) has been preparing an intervention on European mortgage credit market for several years which should lead to faster and more perfect integration.

The European Central Bank defines the fully integrated market of financial instruments or services as a market where all of the potential market parties

- “are subject to a single set of rules when deciding to buy or sell those financial instruments or services,
- have equal access to this set of financial instruments or services, and
- are treated equally when they operate in the market.” [2], [6]

Furthermore, the National Bureau of Economic Research defines the integrated financial market with the following definition:

“In integrated financial markets, domestic investors can buy foreign assets and foreign investors can buy domestic assets. Among countries that are fully integrated into world financial markets, assets with identical risk should command the same expected return, regardless of location.” [10]

Given the above definitions, it is possible to characterize, in relation to mortgage credits, an optimal integrated mortgage credit market where there is a narrow range of interest rates,

highly competitive environment, zero entry barriers and a wide scale of product supplies. The benefit of integration can be seen especially in the increase of individual consumption in the housing segment as well as in the field of other products and, further, in the increase of the total GDP.

The study of European Mortgage Federation and Mercer Oliver Wyman mention three possible ways of future European mortgage credit market integration:

- cross-border clients mortgage crediting as a basic form of mortgage creditor entry to foreign market;
- mergers and acquisitions as a form of mortgage creditor entry to a foreign market by the medium of already existing institutions;
- asset transactions e.g. in the framework of mortgage credits securitization. [11]

The Commission in its published deliberations considers combining all of the above mentioned principles with the dominance of the cross-border clients mortgage crediting.

There has been used an interdisciplinary approach; there have been used logical and systematic methods, documentary observing, comparison, and deduction and induction.

1 The History of European Mortgage Credit Markets Integration

The European Commission has been seeking to gradually integrate European mortgage credit market for several years (especially those mortgages which serve as an instrument for financing housing needs); the Commission considers this activity as a priority for the more efficient functioning of the European Union (EU) financial system and also for the EU economy itself. The reason is a relatively high volume of not repaid balances of mortgage loans on housing in the EU member countries which represents approximately 50 % of the EU GDP. [5]

In 2005 the Commission published a document called Green Paper on Mortgage Credit. The Green Paper was a summary of topics intended for consultation which were related to the possible future integration of the mortgage credit market and Commission's mission in this area [3]. The topics arose from the study of the Forum Group on Mortgage Credit¹ issued in 2004 under the title "The Integration of the EU Mortgage Credit Markets" and referred particularly to the following sections: consumer protection, legal aspects of mortgage crediting, mortgage business securitization, mortgage credit financing.

Simultaneously in 2005, the European Commission settled the Mortgage Funding Expert Group to analyse what could be done to facilitate the development of secondary mortgage markets at the European level.

The culmination of the consultation process which had begun in 2005 was the publication of so called White Paper on Mortgage Credit in December 2007. The White Paper summarizes results of the above mentioned process of the consultations and sets up a complex of measures to improve the efficiency and competitiveness of the EU mortgage credit market focused on housing. These aims should be reached by:

- the facilitation of the cross-border supply and also cross-border financing of mortgage credits. The existence of different legal frameworks and statutes on consumer protection, heterogeneous infrastructure (e.g. in the field of credit registers), as well as a lack of suitable legal regulations generating legal and economic obstacles that bound cross-

¹ The Forum Group on Mortgage Credit was established by The Internal Market Directorate General in 2003 to identify obstacles of further mortgage credit market integration in the EU and to analyze impacts of these barriers on inner EU market functioning.

border credit providing and prevent a development of efficient financing strategies used in the whole Europe.

- increasing the diversity of mortgage banking products.
However, there is available a whole scale of products in the EU, and it isn't possible to say about a single local market that it offers all of the mortgage credit alternatives, concerning product characteristics or a target borrower. In some detail it is a consequence of factors such as consumers' preferences or different business strategies of mortgage creditors. There though exist economic and legal barriers, too.
- the facilitation of consumer confidence and consumer mobility.
The Commission supposes that there cannot exist an efficient market without consumers who have confidence and sufficient information and who are able to find out and choose the best mortgage product for their needs regardless of mortgage creditor localization. For the right choice, consumers need clear, correct, complete and comparable information about different mortgage products. [4]

However, the document was discussed and consequently accepted at the time when nobody assumed the critical development in the area of mortgage credit financing and the subsequent reaction of financial markets. Affairs from the years 2008 and 2009 then led the Commission partly to put off many objectives, which the Commission had defined within the White Paper, partly to their modification and amendments. Still in 2009 the Commission published a summary of the measures about responsible credit lending and borrowing including their intermediation which are related to areas such as: Fairness, transparency and professionalism, Fair advertising and marketing, Professional distribution channels, Competent start, Informed prospective borrower, Information on the offer's period of validity, etc. The Commission thus partially shifted its policy orientation from the process of the integration to the responsible mortgage credit lending.

In addition to the efforts of the European Commission, there operate several institutions that also strive for overcoming barriers, bigger transparency and more perfect competition in the field of mortgage banking on the all-Europe basis. One of the most important institutions in the mortgage-banking area is the European Mortgage Federation established in 1967 which connects national bank associations from all of the EU member states, Norway and Switzerland, and which represents over 75 % of the EU mortgage industry. Its most important objective is to represent the interests of its members at the European level.

2 The Integration Barriers of National Mortgage Credit Markets

As it was mentioned above, the interpretation and comparison of data gained from the mortgage banking institutions acting at the national level seem to be very difficult and complicated especially because of the existing differences in the particular countries.

Among the most important differences, it is possible to sort out the following areas:

- traditions and customs of housing,
- a level of housing and a level of living as a whole,
- actual economic a political situation,
- geographical and climate conditions.

There exist considerable differences among the particular EU member states in the structure of mortgage banking and also in the usage of the terms. The features of mortgage banking are always bound up with the structure of national mortgage credit markets as well as with social customs and historical traditions and also with the terms of regulation and subvention of mortgage banking.

However, the most severe factor is the insufficient data harmonization within the EU that seriously limits the possibilities of comparing the particular countries and setting up a complex view on the European mortgage credit market as well as on the housing market. Nevertheless, on the basis of the official data obtained from the national sources and other records it is possible to design estimations of maturity and a structure of interest rates on the EU mortgage credit market.

Mortgages with the end of the mortgage term longer than twenty years and with the initial fixed interest rate period of 10 years contain a significant role in mortgage contracts. These loans are popular e.g. in Belgium, Germany, France, and in the Netherlands. According to the data from 2004, the share of mortgages with at least a ten-year fixed rate represented circa 50 % of the total amount of the unpaid debt in the EU [7]. This general trend in the EU indeed still prevails, though there can be seen a reverse trend on several national markets in the last years, i.e. a preference for variable interest rates rather than for fixed rates. This anomaly is caused by the applied monetary policy of the national central banks, especially by a significant fall of basic interest rates within the context of the economic recession. This situation also concerns countries with the traditionally significant share of mortgages with a fixed rate such as e. g. Belgium where the share of newly closed mortgages with a fixed rate decreased from 82.7 % in the 4th quarter of 2008 to 32.8 % in the 4th quarter of 2009.

The ways of mortgage refinancing really differ in particular areas. According to the estimation of the European Mortgage Federation, there are two thirds of mortgages set to housing refinanced by Retail Deposits (this rate is even bigger in countries like e. g. Great Britain), followed by Covered Bonds with the share of 20 % (this method of refinancing is common, especially, in Germany, Denmark, but also in Spain, France, Sweden and the Netherlands) and with the share of 5 % on mortgage refinancing Mortgage Backed Securities. However, the share of this - in Europe a relatively new way of mortgage refinancing - rather drops due to recent affairs on the US mortgage market and the consequent economic recession.

The variety of the European mortgage market also concerns a structure of creditors. Mortgage credits in relation to the region are provided by banks (Belgium, the Netherlands, and Portugal), savings banks (Germany, Spain, and the Czech Republic), cooperative banks (the Netherlands, France, and Germany), state banks (Greece, Portugal), and specialized mortgage banks (Germany, Denmark). [9]

Broad differences also appear in state subvention systems, whereas the most sophisticated systems of state subvention of this kind can be found in states of Northern Europe, namely in Finland where the housing fund, which covers these activities, was established in 1993. The advantages of this system of state subvention are especially: simplicity, transparency and a lower demand on administration in contrast to the case in which state subventions are realized via several organizations.

3 Estimated Benefits and Costs of National Mortgage Markets Integration

The key factor in a decision making process of the Commission was the study “The Costs and Benefits of Integration of EU Mortgage Markets” published in August 2005 [1]. The group of experts based their study on the comparison of the future European mortgage market development in the case if the Commission acts (i.e. approach of fast integration) and in the case if the Commission does not make any serious intervention (i.e. likely a path of particular and slow integration). The integration of the European mortgage market is defined for the purpose of this study as an ideal state in which there are identical products of mortgage banking accessible in all of the member states for the same prices.

In order to reach the ideal state of full European mortgage market integration, in the study there were designed these subtargets: reduction of national restrictions on mortgage products supply, creation of terms for mortgage credits securitization and functioning of secondary mortgage market, improvement of real estate registers, assessment of unified European measures within estate evaluation, terms unification of business activities of home and cross-border creditor institutions in the particular countries etc.

The costs of integration are, according to the above mentioned study, primarily represented by the costs of creditor institutions of a new system implementation (implementation of new software, new products, advertising materials etc.) and costs incurred by unrealized contracts (there can decrease an interest by certain types of products in several countries).

The benefit of the integration is thought to be an increase of individual consumption both in the housing area and in the area of other products, and further in an increase of GDP.

Above mentioned costs and benefits of the integration - represented by increased individual consumption - were estimated by a group of experts with the help of the application of earlier elaborated implementation costs studies of regulatory measures on the mortgage market in Great Britain. These costs and benefits are listed in *Tab. 1* [1].

Tab. 1 Comparison of costs and benefits through time € Millions in 2005 prices

Year	Cost	Benefit (Gain in Consumption)
2005	2 398,5	0,0
2006	2 478,4	-9 646,0
2007	2 478,4	-7 939,0
2008	2 478,4	-2 163,1
2009	2 478,4	7 304,4
2010	2 478,4	15 831,2
2011	2 478,4	21 893,4
2012	2 478,4	27 475,1
2013	2 478,4	31 813,6
2014	2 478,4	34 817,2
2015	2 478,4	38 725,3
Discount rate (%)	Net present value of net benefit through 2015	NPV of net benefit as % of EU GDP in 2005
3,0	99 067,1	0,93
3,5	94 567,1	0,89
4,0	90 268,2	0,85

Note: the value of EU GDP in 2005 used in a Eurostat projection.

Source: The Costs and Benefits of Integration of EU Mortgage Markets, Report for European Commission, DG-Internal Market and Services [online]. London: London Economics, p. 106.

Even if most of the subtargets, which the Commission set to realize in the White Paper, have not been fulfilled yet, and the realization of these targets has been temporarily suspended due to the persisting economic recession, it is possible to assume that costs and benefits defined in the mentioned study will probably be noticed in the future after the intervention of the Commission on the mortgage market in the EU.

There can be seen an obvious assumption of great loses in the *Tab. 1* represented by the decrease of individual consumption in the first few years after the intervention of the Commission on the mortgage market in comparison to the situation if the market developed

without the intervention of the Commission. But there is also a rapid increase of this ratio in the following years which highly exceeds assumed costs of the integration. This development seems likely to be influenced by the assumption of the increased activity in the investment area on the housing market in the first years. With the use of the discount rate of 3.5 % is the net present value of benefits of the fast integration reduced by the costs estimated at 94,567 million EUR within 10 years. This value is not final though because there might be realized benefits of the integration in the future.

It is necessary to judge these mentioned estimations very carefully because the study contains a variety of simplifying assumptions; e.g. it does not reflect the influence of different taxation on mortgage markets in the particular countries, and it operates with unfamiliarity with the tools that the Commission may employ. It will also be very difficult to achieve the ideal fully integrated European mortgage credit market. Furthermore, it is essential to take into account the partial innovation of the Commission's subtargets listed in the White Paper and, as already mentioned, the enhanced accent on responsible lending. However, the European Commission has not published concrete measures in this area considering the present complicated economic and political situation yet.

Conclusion

Despite above mentioned local differences, it is possible to characterize the European mortgage credit market as a stable and developed market which grows from region to region faster or slower.

The main advantages that the integration of mortgage markets in Europe may bring to clients of financial institutions consist of the extension of the product supply and the supply of services; further advantages are: mortgage prices reduction especially in the field of fees, and, namely, accessible mortgages for a wider range of clients.

In terms of creditor institutions, there shall be considered the benefits of the integration due to a possible reduction of costs that are needed for refunding as the consequence of secondary mortgage market establishment which is also accompanied by the mortgage financing risk reduction. Another positive aspect of the integration lies in the lowering costs of distribution thanks to an establishment of large transnational creditor institutions. Likewise, the increase of the efficiency of used capital can be considered thanks to the possibility of relocating this capital from less to more profitable markets.

Despite the fact that at present the Commission has partly shifted its political orientation from the integration process to the responsible lending and postponed the fulfilling of the subtargets in the field of national mortgage markets integration within the EU, it is possible to assume that the integration process will be fully restored in the closest future, so that all the benefits of the optimal integrated mortgage market could be realized.

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Ing. Šárka Hyblerová, Ph.D.

INTEGRACE EVROPSKÉHO TRHU HYPOTEČNÍCH ÚVĚRŮ

Evropská komise se již několik let snaží o postupnou integraci evropských trhů s hypotečními úvěry; tuto aktivitu spatřuje jako prioritní pro efektivnější fungování finančního systému Evropské unie i pro hospodářství EU jako takové. Důvodem je relativně vysoký objem neuhrazených zůstatků hypotečních úvěrů na bydlení v zemích EU, který představuje cca 50 % HDP EU. Výsledkem integračních snah bylo v roce 2007 zveřejnění tzv. White Paper on the Integration of EU Mortgage Credit Markets. Tento dokument shrnuje opatření ke zlepšení efektivnosti a konkurenceschopnosti trhů EU s hypotečními úvěry na bydlení. Dokument byl však diskutován a následně schválen v době, kdy nikdo nepředpokládal krizový vývoj v oblasti hypotečního úvěrování a následnou reakci finančních trhů.

INTEGRATION DES EUROPÄISCHEN HYPOTHEKARKREDITMARKTES

Die Europäische Kommission bemüht sich seit einigen Jahren um eine schrittweise Integration des Europäischen Hypothekarkreditmarktes; diese Aktivität wird als Priorität für eine größere Effizienz des EU-Finanzsystems und auch für die EU-Gesamtwirtschaft betrachtet. Der Grund dafür besteht in einem relativ hohen Volumen der ausstehenden Hypothekarkredite für private Wohnbauten in den EU-Ländern, das fast 50 % des BIP der EU beträgt. Aufgrund dieser Bemühungen wurde das sog. Weißbuch über die Integration der EU-Hypothekarkreditmärkte veröffentlicht. Dieses Dokument fasst die Maßnahmen für Verbesserung der Effizienz und Wettbewerbes der EU-Hypothekarkreditmärkte zusammen. Das Dokument wurde jedoch diskutiert und nachstehend zu einer Zeit verabschiedet, als die Krisenentwicklung im Bereich der Hypothekarkredite und nachfolgende Reaktion der Finanzmärkte nicht zu erwarten war.

INTEGRACJA EUROPEJSKIEGO RYNKU KREDYTÓW HIPOTECZNYCH

Komisja Europejska od kilku lat podejmuje próby stopniowej integracji europejskiego rynku kredytów hipotecznych; uważa tę działalność za priorytet efektywniejszego funkcjonowania systemu finansowego Unii Europejskiej, a tym samym i gospodarki UE. Przyczyną jest wielkość niespłaconych kredytów hipotecznych na zakup mieszkań w krajach UE, które stanowią około 50 % PKB UE. Wynikiem tych działań było opublikowanie w roku 2007 tzw. White Paper on the Integration of EU Mortgage Credit Markets. Dokument ten zawiera propozycje środków wspierających poprawę efektywności i zdolności konkurencyjnej rynków UE w dziedzinie kredytów hipotecznych na zakup mieszkań. Dokument ten był omawiany i zatwierdzony w czasie, kiedy nikt nie oczekiwał kryzysu na rynku kredytów hipotecznych i następnej reakcji rynku finansowego.