The Financial Crisis and the Housing Sector: Consequences for Society, the Family and Homeownership
Introduction

• Goal of the presentation:
  – To broaden the discussion about the financial crisis
  – Think beyond issues of regulation and securitisation

• Raise issues that are perhaps being overlooked,
  – or that are only considered during certain windows in the economic cycle

• I have more questions than answers!
  – Questions that lenders must ask of themselves
  – Questions that policy makers must ask of lenders and of housing policy
  – Questions that need to be researched as a matter of priority
• Structure:
  – I. Impacts on House Prices
  – II. Wider Impacts
  – III. Opportunity to reflect on bigger questions
  – IV. Summary
I. How has the financial crisis affected House Prices?

• Most developed countries have experienced a fall in house prices followed by a bounce back effect
Nominal House Prices in Sweden & UK
(1986 q1 = 100)

- Sweden (Real estate price index for one- and two-dwelling buildings for permanent living)
- UK (Nationwide UK quarterly house price index)
• “Overall, the prices increased by 1.8 per cent from the second to the third quarter of 2009”
• house prices in quarter 3 of 2009 “3.8 per cent higher than in the third quarter last year.

Norway (Statistics Norway)
Implication of house price Bounce-Back?

• Q/ Why be concerned?
• Q/ Why not return to business as usual?
1. HP indices do not adjust for liquidity
   - Not comparing like with like
   - Loss aversion ⇒ fewer sellers coming onto the market

2. Wider set of impacts...
II. Wider Impacts

- (a) Impact on transactions-based industries
  - Estate agents, lenders, surveyors, solicitors

- (b) Impact on construction

- (d) Impact on Unemployment & Government debt

- (e) Impact on Repossessions
- UK transactions fell by 70% from peak to trough
  - From 450,000 transactions to 150,000 transactions per quarter
Denmark

- 80% fall in transactions:
  - From 75,000 to 15,000
- So modest house price falls may belie a much bigger impact

**Volumes of transactions – low levels in 2009**

Source: Realkreditforeningen og Realkreditrådet
*Data for 2009 is from January to June.*
(b) Impact on New Construction: Norway

Number of dwellings started. Unadjusted and trend. January 1995-September 2009

2009 © Statistics Norway
Regional Variation in Norway:
% change in number of dwellings started 2008 to 2009

2009 © Statistics Norway
<table>
<thead>
<tr>
<th>Buildings under construction per 30 September, by county. Preliminary figures (2009 © Statistics Norway)</th>
<th>Number of dwellings</th>
<th>% change in number of dwellings started 2008 to 2009</th>
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<td>Total</td>
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<td>529</td>
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</table>
Impact on New Construction: UK

• UK output has fallen by more than half
  – Over 50% of current output is government supported (Whitehead and Scanlon, ENHR Oct 09)
  – Already had one of the lowest rates of newbuild in the developed world.
UK House Building: Number of Dwellings Started
(CLG Nov 2009)
• First global housing-led crisis/recession?
  • (Whitehead & Scanlon 2009)
• UK unemployment rose from 5% to 8% in a year.
“Public sector net debt, expressed as a percentage of gross domestic product (GDP), was 59.2 per cent at the end of October 2009 compared with 48.6 per cent at end of October 2008.

Net debt was £829.7 billion at the end of October compared with £695.1 billion a year earlier.”

(ONS, 2009)
(d) Impact on Mortgage Arrears and Repossessions

• Rise in Arrears & Repossessions due to:
  – Increase in unemployment & fall in earnings
  – Unexpected fall in availability of credit making refinancing difficult…
Rapid contraction of Credit in UK Mortgage Market

Number of residential mortgage products

Mortgage approvals and house prices

Source: Moneyfacts

Source: BoE, Nationwide

Graphs taken from FSA 2009 p. 19 & 20
Repossessions and LFS Unemployment Rate

Source: CML & LFS 2008
Number of Properties taken into Possession

(CML, half-yearly data, 1982H1 to 2008H2)
Rise in loan defaults to households

Even larger rise in defaults on commercial loans
Situation for non-performing loans – still low levels

Non-performing loans

Unemployment rate

Source: Realkreditforeningen/Realkreditrådet and Danish Statistics Department

- From presentation by Flemming Nielsen, ENHR, 1st Oct 09
Impact of repossession

(a) Personal & Social impacts:
- Trauma of repossession has health and motivation impacts
  - Increased visits to the doctor (Nettleton and Burrows 1998)
  - Impact on mental health, depression, addictive behaviours (Armour 2008; Immergluck 2009, p.147)
- Higher foreclosure levels contribute to higher levels of violent crime (Immergluck and Smith 2006)
- Impact on children:
  - Schooling -- probability that children will graduate from high school (Haveman and Wolfe 1994; Rumberger 2002; Immergluck 2009 p.146; Lovell & Isaacs 2008)
  - Health & emotional trauma (Lovell & Isaacs 2008)
• (b) Impact of repossessions on risk/return trade-off for low income homeowners
  – Negative ratchet effects for the poor
  – **Hypothetical example:**
    • Assume 4 cycles in a typical housing career
      – (i.e. boom every 10 years)
      – each broken into 2 periods: upswing & downswing.
      – Total of 8 intervals connecting 9 time points: $t_1$ to $t_9$. 
Negative Ratchet Effects for the Poor?

• House price:
  = £80,000 in \( t_1 \)
  = £280,000 in \( t_9 \)

• Rental costs = mortgage costs
  = £3,000 per year; i.e. £120,000 over 40 years.

• RPI = 0 (or calculate in real terms).

• 3 types of person:
  – Person A: enters OO at \( t_1 \) and stays in OO until \( t_9 \)
  – Person B: enters OO in slumps and leaves during booms;
  – Person C: enters OO in booms and leaves during slumps
Person A – stays in OO for entire housing career

- Person A:
- Stays in OO \( t_1 t_9 \)
- Gross Revenue
  \[= £280,000 - £80,000\]
  \[= £200,000\]
- Now take away rental/mortgage costs of \( £120,000 \)
- Net profit of \( £80,000 \) assuming no transactions costs.
• Person B: Enters OO during troughs and leaves during peaks
• Gross Revenue = £70,000 in $t_1t_2$ +£70,000 in $t_3t_4$ +£70,000 in $t_5t_6$ +£70,000 in $t_7t_8$ = £280,000
• Now take away rental/mortgage costs of £120,000
• Net profit of £160,000 assuming no transactions costs.
Person C – enters OO during peaks & leaves during slumps

- **Person C:**
  - Enters OO during peaks and leaves during troughs
  - **Gross Revenue**
    - £-20,000 in $t_2t_3$
    - £-20,000 in $t_4t_5$
    - £-20,000 in $t_6t_7$
    - £-20,000 in $t_8t_9$
    - **£-160,000**
  - Now take away rental/mortgage costs of £120,000
  - **Net loss of £280,000**
    - assuming no transactions costs.
• Is there more chance of being Person C if you are poor, due to the coincidence of credit and employment cycles?
  – Housing slump:
    • house prices are low, but can’t buy unless you have a large deposit because credit market also in a slump.
    • Only the cash-rich can take advantage of low HPs.
    • If you already own, more likely to face unemployment if in unskilled or semi-skilled due to more volatile nature of jobs.
  – Housing boom:
    • Credit market also in a boom; lax lending, 100% mortgages, entices low income/high risk HHs
• Boehm and Schlottmann (2004 p.128) find ‘a high likelihood that lower income families will “slip” back to renting after attaining homeownership.’
  – They conclude that,
    • “To the extent that low-income and/or minority families are unable to adjust their level of consumption of owned housing freely and may even have a high likelihood of returning to rental tenure, homeownership may be less beneficial than it otherwise might be” (Boehm and Schlottmann 2004 p.129).
• Is it possible that home-ownership may actually reduce the wealth accumulation prospects for such households in the long term?
  – high transactions costs associated with moving in and out of home-ownership
    • solicitors’ fees, mortgage arrangement charges, estate agent charges, survey costs, Stamp Duty
    • the size of these costs probably larger in relative terms for low earners
III. Reflecting on Bigger Questions

• Financial Crisis and World Recession provides an opportunity to reflect about the bigger questions
  – As economies and housing markets recover, the opportunity to think seriously about these questions will pass

• Collective amnesia and irrationality sets in as markets boom
  – E.g. When Allied forces landed on the shores of the Dardanelles in 1915, troops bribed one another for a place on the frontline. The market price for the privilege of spearheading the anticipated victory was not, it transpired, based on a realistic assessment of what Gallipoli held in store.
  • Only after the war ended did society realise the true cost of the Gallipoli campaign: more than a quarter of a million casualties.
  • Market participants do not, it seems, always possess the omniscient rational faculties often ascribed to economic man. This seems particularly true in the fog of war and
Reflecting on Bigger questions:

1. Do banks need to fundamentally change their organisational ethos?
2. Do we need to change the structure of mortgage finance?
3. How can communities become more robust to financial shocks?
4. Do we need to reconsider the pros and cons of homeownership?
5. Are our current tenure structures well suited for dealing with the challenges that lie ahead for European societies?
Q1/ Do banks need to change their operating ethos?

- Major attempts underway to change the regulation of banks
- But regulation only part of the solution
  - Always a way for banks to find loopholes in regulation if they have the will to do so
  - Cat and mouse game between regulators and lenders is a dangerous one
    - Can have profound effects on society and the world economy

Q/ How many regulators does it take to change a light bulb?
Q1/ Do banks need to change their operating ethos?

A/ All depends on whether the light bulb really wants to change!

- Need to change the ethos of lending
  - Unless lenders have the will to genuinely change their organisational structures and ethos, particularly at a senior level, regulation will be impotent to prevent future crises.
Q1/ Do banks need to change their operating ethos?

• Not an unrealistic proposition?
  – 1. In the long-run, lenders themselves have a vested interest in stability and ethical lending
  – 2. Not all lenders have the same ethos
    • E.g. Treatment of borrowers in arrears varies hugely across countries, between lenders and over time.
    • Ergo, if one lender can operate ethically, so can all lenders.
Q1/ Do banks need to change their operating ethos?

• E.g. 260,000 in households in arrears in the Republic of Ireland in 2009 q1, but only 33 repossessions!
  (O’Connor, ENHR 2009)
  – So Irish ratio of repossessions to arrears = 0.01%
  – One thousandth of the UK ratio!
    • UK 2009q1 ratio of repossessions to arrears = 10%
• UK ratio also change considerably over time:
Q1/ Do banks need to change their operating ethos?

Mortgage Repossessions as % of arrears

Source: Janet Ford, ENHR Cambridge, 2009
Q1/ Do banks need to change their operating ethos?

**Becoming an ethical lender…**

- **Ethical lending and investment**
  - i.e. lending & investment practice that takes into account the wider impact:
    - Impact on the welfare of the borrower
    - Impact on society of excessively risky lending and investment

- **Ethical forbearance**
  - i.e. policy towards defaulting borrowers that takes into account the social and psychological impacts of foreclosure
  - E.g. Janet Ford (2009) observes a shift in recent behaviour of UK lenders:
    - "Strategic shift from 'pay or possess' to 'managed forbearance'
    - "greater use of advice services"
    - "assisted sales"
    - "waiving redemption fees of fixed high rate interest to facilitate switching"

Will it last?
Why not the norm?
Taking steps towards ethical lending

1. **Transparency**
   - Data on arrears and repossessions very difficult to find in some countries
   - Why?

2. **Organisational & Ownership structure**
   - E.g. in early 1990s mortgage crisis, Building Societies (mutuals) approach to mortgage defaults was very different
     - Different organisational ethos
   - If ethical banking is discouraged because of organisational & ownership structures, what do we need to do to change those structures?
     - Banks too important to the world economy and the wellbeing of society to evolve organisational & ownership structures that lead to unethical behaviour

Q1/ Do banks need to change their operating ethos?
Q1/ Do banks need to fundamentally change their organisational ethos?

Q2/ Do we need to change the structure of mortgage finance?
Lessons to learn from the UK experience:

- Cost to UK taxpayer of bailing out banks
  - Massive increases in government debt and hence escalating interest payments on that debt
  - Huge pressures to cut public spending
    - Cuts in education, health, welfare, care for the elderly

- Why was Britain so vulnerable?
  - Very large mortgage sector
    - high % OO
    - high mort/GDP
  - high initial LTV
    - Inevitable if prices rising faster than income
  - v. low % FRMs

- Important because:
  - Mortgage market has high impact on macro economy if large OO sector, and hence mortgage sector, is large.

Q2/ How should mortgage finance systems be structured?
Denmark & UK:
• Both have high mortgage debt relative to GDP (over 80%)
• But in UK, only 1% of new fixed rate mortgages > 10 years,
• compared with 50% in Denmark and 52% in US

<table>
<thead>
<tr>
<th></th>
<th>Mortgage debt to GDP (%)</th>
<th>Owner occupation (%)</th>
<th>Typical initial LTV (%)</th>
<th>Specialist mortgage products</th>
<th>New fixed-rate mortgages (% &gt;10 years)</th>
<th>Explicit pre-payment charges</th>
<th>Funding model</th>
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<td>70</td>
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Massive growth in real estate leverage...
And not just in the UK

Residential Mortgage Debt % GDP

(Source: EMF Hypostat)
Increase in Mortgage Leverage

% point increase in Residential Mortgage Debt as % of GDP Between 1998 and 2007

(Source: EMF Hypostat)

<table>
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<tr>
<th>Country</th>
<th>1998</th>
<th>2007</th>
<th>Percentage point increase</th>
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<tr>
<td>Sweden</td>
<td>45%</td>
<td>57%</td>
<td>13%</td>
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<td>Norway</td>
<td>40%</td>
<td>53%</td>
<td>14%</td>
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<td>Denmark</td>
<td>75%</td>
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<td>UK</td>
<td>51%</td>
<td>86%</td>
<td>36%</td>
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<tr>
<td>Iceland</td>
<td>49%</td>
<td>121%</td>
<td>72%</td>
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Growth in mortgage finance made possible by securitisation.

CFG increased by more than 1500% (from 40bn to 700bn in 7 years).

Note: Customer funding gap is defined as customer lending less customer funding, where customer refers to all non-bank borrowers and depositors.
Part of a wider picture of indebtedness

- Further vulnerabilities in the UK:
  - **High levels of unsecured debt**
    - credit card debt has risen by more than 100% in ten years,
    - and by a thousand per cent since the last pre-slump period 20 years ago
      - (in 1987, total outstanding credit card debt stood at £5bn; it has since risen to £55bn).
  - **Rise in second, third and fourth charge mortgages**
    - Not regulated by FSA: data?
    - High risk because second charges are taken out when the first charge lender would not advance further funds.
  - **Rise in corporate defaults**
    - As the UK economy slows, there could be a spike in commercial foreclosures.
    - E.g. US Investors expect a 10% default rate over the next 12 months, according to Garman Research (Telegraph, 1st Oct 2008)
Part of a wider picture of indebtedness

**Fragility of wider financial system**

- US total credit market debt as %GDP is now well above the level that preceded the Great Depression
- Leverage a major source of economic vulnerability
Q2/ How should mortgage finance systems be structured?

- Costs and risks of lending need to be kept within the market and not borne by wider society (FSA 2009)
  - Q/ Does the social cost of borrowing exceed private cost of borrowing, particularly when overall leverage reaches high levels?

- We can ask a similar question of homeownership:
  - Q/ Does the social cost of homeownership exceed the private cost of homeownership when homeownership rates reach high levels?
Not just lenders to blame…

• Incentives of lenders and borrowers need to be more aligned with the welfare of society
• But is this achievable if tax system makes housing attractive as a speculative investment?
  – Growth in mortgage debt to GDP not due to growth in LTVs…
  – Have to tackle tax favourability of homeownership and stability of other forms of investment (pensions).
Q2/ How should mortgage finance systems be structured?

Growth in Mortgage Debt/GDP not due to ↑LTV:

Average Loan-to-Value, by type of borrower

Proportion of borrowers taking higher LTV loans (90%+)

Source: FSA 2009 p.38

*Note: data excludes properties sold at discounted prices in 1983 - 2001
Q2/ How should mortgage finance systems be structured?

Rise in UK Loan to Income Ratios on new mortgages

Average Loan-to-Income compared to Average Price-to-Income

Source: FSA 2009 p.38
Q2/ How should mortgage finance systems be structured?

UK House Price Growth Relative to Income

Average annual house prices and other economic indicators (Baseline: 1990=100)

Source: FSA 2009 p.17
Q2/ How should mortgage finance systems be structured?

Impact of LTV on Pr(default) is questionable

- Neither initial LTV nor current LTV were significant in any of the regressions...
BHPS Random Effects Panel Logit Model of Arrears: Includes initial LTV and current LTV

Table A: Testing the Equity Theory of Default

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<td>(Hedonic)</td>
<td>Capital Gain</td>
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<td>1.000</td>
<td>1.000</td>
<td>1.000</td>
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<td>(0.08)</td>
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<td></td>
<td>(2.44)</td>
<td>(2.30)</td>
<td>(0.88)</td>
<td>(0.45)</td>
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<td>+ Control Variables</td>
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<td>5 Predicted Capital Gain</td>
<td>6 Predicted Capital Gain</td>
<td>7 Predicted % Capital</td>
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<td>(Hedonic)</td>
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<td>(-0.14)</td>
<td>(0.11)</td>
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<td>+ Control Variables</td>
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(Figures in brackets are z-values)
Q1/ Do banks need to fundamentally change their organisational ethos?
Q2/ Do we need to change the structure of mortgage finance?
Q3/ How can communities become more robust to financial shocks?
Q3/ How can communities become more robust to financial shocks?

- We cannot remove the possibility market crises
  - they are fundamental to capitalism
    - Keynes: argued that the future is unknowable,
      - economic storms, especially those originating in the financial system, are not random shocks which impinge on smoothly-adjusting markets, but part of the normal working of the market system -- Skidelsky 2009).

- So can we make households and communities more robust to financial shocks?
  - we need to think beyond financial regulation and reform.
1. Mixed Communities

- Are more integrated communities more robust to financial shocks?
  - If so, financial sector has an incentive to promote social cohesion and stability.

- Poor people in integrated communities (ones where there is a mix of rich and poor) may be less affected by the impacts of the financial crisis.
  - One reason that this might be the case is the effect of "contagion" -- the knock-on effects of repossessions on the value of surrounding houses
    - (Harding et al 2009, JUE, Schuetz, et al. (2008)).
    - unpublished work by Baddeley (2005) that finds evidence that repossessions are part of a herding effect that drives house price volatility.
  - This leads to the possibility of spatial tipping points if too many repossessions are located close together.
Q3/ How can communities become more robust to financial shocks?

2. Family Stability

- Family fragmentation reduces robustness
  - Separation/Divorce a major driver of repossession
  - Incidence of divorce has been rising over a long period.

- Also, relationship breakdown leads to smaller households.
  - In the UK, for instance, the population has not increased by as much as the increase in number of households, and this is one of the main pressures on housing.
    - Increased prices
  - The question is whether more integrated communities and extended families help make society more robust to financial crises.

- Again, this is an example where we might have cause to look beyond financial regulation in the quest for stability.
  - E.g. we might ask whether mobility of labour and the drive towards more flexible labour markets has itself perpetuated social fragmentation.
### Bhattacharjee, Cairns and Pryce (2009) Analysis of Mortgage Arrears using the BHPS

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Pseudo R²</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pr(Unemp)</td>
<td>1.096</td>
<td>0.147</td>
<td>26,667</td>
</tr>
<tr>
<td>Savings</td>
<td>0.164</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sep/Div.</td>
<td>2.937</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MPPI</td>
<td>0.698</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>0.978</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

+ year dummies

- while LTV not significant, Pr(unemp) and Sep/Divorced are highly significant.
- Having MPPI has a large effect on reducing arrears, but not as large as having savings.
- Odds of arrears falls with age
Q1/ Do banks need to fundamentally change their organisational ethos?
Q2/ Do we need to change the structure of mortgage finance?
Q3/ How can communities become more robust to financial shocks?
Q4/ Do we need to reconsider the pros & cons of homeownership?
Q4/ Do we need to reconsider the pros & cons of promoting homeownership?

- (i) Swings in housing wealth inequality
- (ii) Affordability – implications for renters
- (iii) Unequal Risk/Return Trade-offs for different income groups of homeowners.
- (iv) Social Benefits to homeownership remain unproven
- (v) Large homeownership sector leads to price volatility and larger impacts on economy?
Massive Swings in Housing Wealth and Inequality

• Large swings in housing wealth inequality among homeowners
  – Probably no LT upward trend
  – But do these massive swings matter?

Figure 1. Combining Thomas & Dorling and Land Registry Data

DRIP = Decile ratios calculated assuming *initial* period (*t* = 1) categorisation of price levels;
DRFP = Decile ratios calculated assuming *final* period (*t* = *T*) categorisation of price levels.
• One particular concern is that large swings in housing wealth may distort labour supply decisions.
  – Textbook labour supply theory suggests that capital gains will “reduce the incentive to supply labour as they reduce an agent’s marginal utility of wealth…”
    (Henley; 2004, 439-40)
  – Henley found significant reductions in hours worked following real housing gains.
(ii) Implications for Renters

- Relative position of renters:
  - Entire UK price distribution shifted
  - In long run, similar % increase in all price brackets

- Preferential treatment of homeownership disadvantages the poorest in society
  - Growing gulf between owners and renters?

(a) House Prices without Rescaling

Source: All Land Registry Sales in England and Wales
Q4/ Do we need to reconsider the pros and cons of promoting homeownership? (cont’d)

(b) House Prices with Uniform Proportionate Rescaling

Implies that all houses have increased in value by a similar proportion

no change in shape of distribution

Source: All Land Registry Sales in England and Wales
(iii) Unequal Risk/Return Trade-offs

Homeownership has been promoted by successive governments since WWII in developed and developing countries around the world.

But is the promotion of homeownership to low income groups based on evidence?

Usually assumed that if the average long term return to homeownership is high, then we should help low income households gain access

- Have the risk/return trade-offs been computed for different socio-economic groups?
- Main objective of housing policy is then how to help first time buyers, provide affordable homeownership etc.
- Absence of definitive evidence on social benefits.
Less favourable Risk/Return Relationship?

Even if poor and rich areas have the same mean trajectory, there may be a wider span of trajectories:

Affluent Areas

Poor Areas
Q4/ Do we need to reconsider the pros and cons of promoting homeownership? (cont’d)

**Greater variation in house price growth in lower price areas?**
Higher costs of borrowing for the Poor?

- Low income HHs tend to borrow with higher debt gearing
  - Higher LTV, higher interest rate
- More likely to have an “Impaired credit rating”
  - Pay a higher risk premium, particularly if from a subprime lender.
• More likely to be **poorly informed** and make poor mortgage choices
  – E.g. choose teaser-rate mortgages that may be bad value in the long-term.
  – Less likely to update and regularly shop around for better mortgage products
• More **susceptible to being exploited** by fraudsters, loan-sharks, subprime salesmen, unscrupulous estate agents etc.
(iv) Unproven social benefits of OO

- Myth of homeownership?
  - See Haurin review (JUE)
- E.g. Children of homeowners do better
  - But is this because those who enter homeownership more likely to invest in education, saving etc anyway?
(v) OO and Price Instability and Macro Instability

E.g. Germany has low OO rate (43%) and low mortgage debt to GDP (53%)

also has relatively stable house prices…

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2007</th>
<th>Percentage point increase:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>45%</td>
<td>57%</td>
<td>13%</td>
</tr>
<tr>
<td>Norway</td>
<td>40%</td>
<td>53%</td>
<td>14%</td>
</tr>
<tr>
<td>Denmark</td>
<td>75%</td>
<td>93%</td>
<td>18%</td>
</tr>
<tr>
<td>UK</td>
<td>51%</td>
<td>86%</td>
<td>36%</td>
</tr>
<tr>
<td>Iceland</td>
<td>49%</td>
<td>121%</td>
<td>72%</td>
</tr>
</tbody>
</table>
Note: graphs from Goodhart and Hofman (2008) and show year-on-year percentage changes in nominal house prices (solid lines) and in real house prices (dotted lines).
• Important to look again at the efficacy of OO because:
  – the larger the size of OO sector the **stronger the link between the housing & macro-economy:**
  • Goodhart and Hoffmann (2008) use panel data on 17 industrialised countries to assess the links between money, credit, house prices and economic activity:
    – (i) evidence of a significant multidirectional link between house prices, monetary variables, and the macroeconomy.
    – (ii) link between house prices and monetary variables is found to be stronger over a more recent sub-sample from 1985 to 2006.
    – (iii) effects of shocks to money and credit are found to be stronger when house prices are booming.’ (p. 180).
When weighing up the costs and benefits of OO consider:

- Negative ratchet effects for the poor?
  - Fundamental incompatibility of short-term employment contracts and long-term mortgage contracts.
- Less favourable risk/return trade-off?
- Higher costs of borrowing?
- Social and economic implications of repossessions and high debt gearing
- Can we have a large OO Sector without Increasing the fragility of the mortgage sector & wider economy?
  - Expansion of homeownership plus rising house prices means greater leveraging
    - Impact on wider economy
  - Larger OO sector implies stronger link with macro economy?
Q1/ Do banks need to fundamentally change their organisational ethos?
Q2/ Do we need to change the structure of mortgage finance?
Q3/ How can communities become more robust to financial shocks?
Q4/ Do we need to reconsider the pros and cons of homeownership?

Q5/ Are our current tenure structures well suited for dealing with the challenges that lie ahead for European societies?
Q5/ Is homeownership the best tenure for dealing with future challenges?

- Europe in 2100: High Emissions

Source: Dr Sylvia Knight, Open University, climateprediction.net & open2.net projects.
E.g. Climate Change Europe in 2100: High Emissions

**Flood Risk**

2002 vs 2080

Source: *Foresight Report 2002*, assuming medium/high emissions

**House Prices, employment?**

Source: *BBC*
Physical Impacts:

- ↓ crop yields
- ↓ clean water
- ↑ foods/sea levels
- ↑ storms

“Such changes would transform the physical geography of the world. A radical change in the physical geography of the world must have powerful implications for the human geography - where people live, and how they live their lives.”

(Stern, 2006, p.iv)

Impact on every area of human enquiry...
• Credit Crunch has revealed the fragility of a homeownership dominated tenure system.
  – Lack of diversification for individuals
  – Level of debt gearing in wider economy:
    • Leads to Potentially fragile financial & economic systems
• If Climate Change unfolds as predicted
  – Homeownership may be relatively inflexible and unstable
  – Also entails perverse incentives:
    • E.g. building on flood planes
    • E.g. aversion to adaptation due to signalling effects
• Would it be better to face these challenges with:
  – Larger private rented sector
  – Dominated by large, institutional landlords that can:
    • Diversify risk across areas & time periods
    • Have limited liability
    • Regulated in terms of adaptation to flood risk, carbon emissions etc.
IV. Summary

• Looked at the impacts of the financial crisis
  – House prices
  – Transactions & construction
  – Unemployment & government debt
  – Repossessions

• Argued that the financial crisis has also highlighted deep weaknesses in our mortgage finance system and tenure structure
  – Raises bigger questions than regulation of banks
Q1/ Do banks need to fundamentally change their organisational ethos?

Q2/ Do we need to change the structure of mortgage finance?

Q3/ How can communities become more robust to financial shocks?

- Q/ Does the social cost of borrowing exceed private cost of borrowing, particularly when overall leverage reaches high levels?
Q4/ Do we need to reconsider the pros & cons of homeownership?

Q/ Does the social cost of homeownership exceed the private cost of homeownership when homeownership rates reach high levels?

- **1. Costs of Inequality:**
  - Timing of entry & exit
  - Fundamental incompatibility between LT mortgage contracts and ST employment contracts
  - Renters face lower rates of wealth accumulation

- **2. Costs of Bailing out borrowers:**
  - Significant intervention needed to alleviate repossessions in downturns
  - Arrears & repossessions probably depress house prices and consumer confidence, may further destabilise the financial system and have a significant effect on growth

- **3. Costs of Bailing out Bankers & the Economy:**
  - Systemic risk & economic instability
Q5/ Are our current tenure structures well suited for dealing with the challenges that lie ahead for European societies?
• Thank you!