Interactions between the financial crisis and national housing markets

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1 Background

In 2011 the Journal of Housing and the Built Environment (HBE) published a special issue entitled ‘The credit crunch and the resilience of housing systems’ (guest editors: Hugo Priemus and Duncan MacLennan) (Vol. 26, issue 3: 237–384). Credit crises (of which there are many) rarely last more than a couple of years. In this case however the outcome of the global financial crisis has been a continued constraint, in particular on many wholesale financial markets. The credit crunch has morphed into a longer term debt crisis, an Euro crisis, and widespread recession, with unemployment in the Eurozone rising to 12 % at the beginning of 2013. As a result of these negative dynamics many governments have seen the only option as cutting national budgets and resetting political priorities. This has not only impacted on house prices and consumer confidence but has also had varying and mainly negative impacts on housing markets and construction across Europe, including reductions in residential mobility, increasing difficulties in providing mortgage loans, housing demand shifting from buying to renting and from the top-end of the market to lower segments, a reduction in housing transactions and large-scale reductions in housing investment. As a result we observe countries where the persistent problems of the housing market have had negative impacts on the general economy: lower output in house building and real estate related economic sectors, decreased profits and increased bankruptcies, higher unemployment and higher expenditure on unemployment benefits.

While the immediate effects were generally similar across countries, after a few months they started to diverge significantly. At one extreme in France, investment is close to 2007 levels and the housing market has been relatively resilient—although a decline is now expected. In Germany although there have been problems in the banking sector, housing finance has worked well and the main negative impact has been on investment levels. Now,

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house prices are increasing rapidly in some regions and owner-occupation is increasing. In Ireland and Spain, on the other hand, the earlier boom in housing investment massively distorted their whole economies so that the crisis and its consequences for housing generated large scale and continuing negative outcomes for financial institutions, construction activity and consumers alike.

Government responses have also been very different across countries. In Ireland and Spain massive economic restructuring has been required as a result of the collapse of investment, the banking sector and European bailout requirements. At the other, in countries such as Germany and Sweden (and, outside the EU: Norway and Switzerland) housing markets have returned to near normal in terms of funding if not with respect to construction activity without significant government intervention. In between, there has been a multiplicity of responses varying from economic stimulation notably of infrastructure and housing investment to large-scale reductions in both supply and welfare subsidies, sometimes both at the same time.

2 The spectrum and trajectory of change

In this special issue 'European housing systems: responding to financial, economic and political stress' we examine experiences, approaches and explanations relating to the interactions between the developing financial and economic crises and national housing markets in a broad range of countries in the European Union.

Table 1 organises the countries included in the special issue by the impact of the financial crisis. Ireland at one extreme is still in the throes of adjustment; followed by the UK and the Netherlands both of which had high debt to GDP levels and were heavily affected into the longer term; then by two countries Australia and France where government management effectively limited the impact through stabilisation policies in the case of Australia and regulation and subsidy in France. In the final three countries there has been little impact on the mortgage markets, in Sweden and Germany because the immediate effect of the crisis on the real economy and thus housing and mortgage markets was very limited after the immediate shock; while in Italy the formal mortgage market is relatively unimportant as compared to family support.

The table clarifies how different the perceptions of housing markets and the role of government was before the crisis. Those countries with rapidly rising debt and prices were expecting adjustment but hoped for a soft landing. Those with more managed or regulated systems were in a far better place to address the immediate issues which affected all countries for the first few months and were more able to maintain reasonably well operating mortgage markets. Where there was a significant impact, the immediate policy response in terms of stimulus packages followed by the introduction of additional regulatory constraints was the norm, except where public expenditure constraints were binding. In all countries there were indications that regulation would be strengthened—but this has required considerable time to implement.

But no country, except France with very large-scale subsidies, has been able to bring investment levels back to pre-crisis normality. Moreover, as the financial crisis morphed into a more fundamental and longer lasting debt crisis and then into economic recession many governments introduce policies to control expenditure which have reduced and restructured subsidies. In some countries there is an element of 'never waste a good crisis' resulting in a greater appetite for difficult policy change in the face of economic and financial pressures. Notably in the UK and Sweden, this has enabled the continuation of

Table 1 How the crisis evolved

Country	Perceived pre-crisis position	Transmission of crisis to housing	Government policy—immediate	Government policy—longer term
Ireland	Open financial system; Rapid rises in output, debt and prices	Lack of credit to developers and consumers; Declining output levels; Consumer distress; Lack of confidence	Nationalisation of banks; Protection for mortgagors	Regulatory changes to make lending more secure; Continued protection of indebted owner-occupiers
Netherlands	Open financial system; Rapid rises in debt and prices	Lack of credit to developers and consumers; Declining output levels; Limited consumer distress; Lack of confidence	Stimulus package for housing construction; Support for moving owner-occupiers	Regulatory changes to restrict lending including maximum LTV at 102 %; Restrictions on tax relief for owners; Deregulation of planning, security of tenure and social housing; Continued specific assistance for established owners but heavy taxation of social housing
UK	Open financial system; Rapid rises in debt and prices	Lack of credit to developers and consumers; Declining output levels; Limited consumer distress; Lack of confidence	Stimulus package; Protection for mortgagors in arrears	Regulatory changes to restrict lending to more secure borrowers; New instruments to support development and first-time buyers; Continued shift away from supply subsidies and restrictions on welfare payments
Australia	Well organised securitisation market; Continued financial stabilisation policies; Rises in debt and prices constrained	Lack of credit mainly to developers; Lower output levels; Lack of confidence—but all very short lived	Stimulus package; Intervention in mortgage market; Help to first time buyers and to rental sector	Continued financial stabilisation and assistance policies; Interest rate management; Loan to value ratios limited and savings requirements increased
France	Government supported finance and housing; Strong regulatory constraints on access to owner-occupation; Slowly rising debt and prices	Limited impact on credit; Output levels maintained; few effects on consumers	Stimulus package for all three tenures; Government support for first-time buyers and owner-occupiers in general	Continued government involvement across the finance system and for all tenures; Concern about sustainability of policies

Table 1 continued

Country	Perceived pre-crisis position	Transmission of crisis to housing	Government policy—immediate	Government policy—longer term
Sweden	Open economy; Prices and debt rising; Low output levels; large rented sector	Limited impact on credit; lower output levels; Rapid adjustment to normality	No immediate response seen as necessary	Some tightening of mortgage market regulation including loan to value ratios limited to 85 % Restructuring the welfare state extended
Germany	Regulated financial system; stable prices and output; Strong private rented sector	Little effect on credit availability; Continued normality; Lower output levels	No immediate response seen as necessary	No significant policy change
Italy	Closed financial system; Family as important as debt finance; House prices rising; Government policies to support social housing	A credit pinch rather than a crisis but impact stronger on the overall economy leading to declining economic capacity	No immediate response as growing constraints on public expenditure	Social housing initiatives reversed and national funding heavily constrained—few local resources available

much longer term policy trends to make housing more self-sufficient, while in the Netherlands it has allowed far tougher attitudes to social housing to emerge at the same time as making the first steps to reduce tax relief for owner-occupier mortgage debt. Perhaps most concerning has been the rapid reversal of policies to support the very limited social housing available in Italy.

By comparing these different trajectories it becomes clear that there are different pressures affecting mortgage markets as compared to housing markets. In countries with more market oriented mortgage systems immediate responses were often necessary to support households with high debt levels and financial institutions with large housing portfolios and increasing bad debts. In more managed systems the opportunity was sometimes taken to strengthen mortgage regulation but problems were usually confined to the treasury management side of banks because of other factors such as exposure to foreign and regional rather than mortgage debt.

In terms of housing markets there are big differences with respect to house prices—with some very large declines, other systems where prices have not fallen as much as might have been expected and a few where prices have been fairly stable. The similarities across almost all the countries included here has been in much lower investment and transactions—whether or not the funding has been available.

After 5 years the trajectories of change are still by no means clear, although in almost all the countries included in the special issue there are concerns that markets are not stabilised—with rapid house price increases in Germany and Sweden and even in some parts of Ireland and England (as well as the United States); increasing concerns that assistance to consumers cannot be maintained; and continuing pressures on public expenditure across Europe. The one clear reality is that housing investment and transactions, unless government sponsored, are at best recovering very slowly. The resultant continuing housing shortages have significant adverse consequences for those in housing need in many countries of Europe.

3 The contributions

After this introduction we look first at the paper by Mark Stephens and Christine Whitehead (UK): ‘Rental housing policy in England: post crisis adjustment or long term trend?’ which reflects the tensions between longer term pressures and the immediate need for deficit reduction. The authors conclude that the majority of housing policy changes over the longer term has generally been bi-partisan and incremental but that sudden external pressures have speeded up the rates of change both in the 1970s and since the financial crisis. As a result there is a continuing shift towards demand side subsidies and increasing pressure on lower-income households to make higher contributions to their own housing costs.

The paper by Peter Boelhouwer and Hugo Priemus (NL) deals with the ‘Demise of the Dutch social housing tradition: impact of budget cuts and political changes’. The Netherlands appears to have been particularly vulnerable to the financial crisis because of its international position and the size of the Dutch banking sector. In the aftermath of the credit crunch housing reforms were introduced, dominated by huge public budget cuts. The housing associations are confronted with a new Landlord Levy of about 1.7 billion euro annually, which will strictly limit their investment capacity while current austerity measures may even lead to the demise of the Dutch social housing tradition.

'Swedish welfare state and housing markets under economic or political pressure' is the title of the contribution by Emma Holmqvist and Lena Magnusson Turner (Sweden) which again reflects upon the structural changes in support for housing. The Swedish financial system was little affected by the financial crisis and there was very limited transmission to housing policy. This is seen to be significantly the outcome of lessons learned in the earlier 1990s crisis when more effective regulation, similar to that found in Australia, was put in place. This shorter term success has been accompanied by continuing decline in the Swedish welfare state model housing, traditionally a core value, as a result of deregulation and liberalisation. As a result the share of the rented sector has decreased, while ownership and speculation have grown. Affordability is a key problem now, especially as house prices begin to rise again and unemployment is predicted to increase. While this financial crisis has been overcome, the concern must be that the system is much less resilient than in the past.

Stefan Kofner (Germany) then describes 'The German housing system: fundamentally resilient?'. The macro-economic stability and the regulatory frameworks in the German economy partly explain why the German housing system was not greatly affected by the financial crisis. But equally there was no pre-crisis excess in the German housing market. Low ownership rates and a large market share of private renting can be observed with regulation and housing subsidies, if anything biased towards rental. These characteristics appear to help stabilise the system. Yet there are pressures now emerging in particular markets which can be partly explained by that regulatory framework.

Christian Tutin and Bernard Vorms (France) in their paper 'French housing markets after the subprime crisis: from exuberance to resilience' explain why the French housing market, while relatively buoyant earlier, stabilised so rapidly after 2007. Many factors emerge as important including the specifics of the government sponsored credit system and recent trends in tenure, urban structures, income distribution and housing policies. There are some, perhaps surprising, similarities with developments in the Nordic countries, where housing systems have been more resilient than in the more market oriented systems in the Anglo-Saxon countries. However there are also concerns as to whether government policy can be sustained into the future.

The contribution by Michelle Norris and Dermot Coates (Ireland) clarifies 'How housing killed the Celtic tiger: anatomy and consequences of Ireland's housing boom and bust'. The authors outline the most significant features of the housing boom (1996–2006) in Ireland and explain how it generated and disguised crucial underlying risks in the macro economy, public finances, mortgage lenders and household finance. The key features of how the boom unwound since 2007 are presented. Lessons are drawn from the Irish experience about appropriate regulatory and policy responses to large-scale house price and investment booms.

Massimo Baldini and Teresio Poggio (Italy) give an overview of the Italian experience in their contribution, under the heading 'The Italian housing system and the global financial crisis'. In Italy the financial crisis has led both to further restrictions on housing policy and to a reduction in the economic capacity of households and municipalities. The crucial role of the family in funding home-ownership together with certain policy measures have softened the impact of the credit crunch on the housing market in Italy. Affordability for those not protected by family remains a massive problem; social housing is collapsing and there is uncertainty about the future of government social housing programmes which were developed before the crisis.

Kathleen Scanlon (UK) and Marja Elsinga (NL) compare the developments and policies in two countries on opposite shores of the North Sea: the United Kingdom and the

Netherlands. Their contribution deals with ‘Policy changes affecting housing and mortgage markets: how governments in the UK and the Netherlands responded to the GFC’. Both countries had high debt levels but responded to the global financial crisis in different ways—dependent on past experience and institutional structures. In the Netherlands mortgage interest deductions and mortgage guarantees are important yet part of the problem. In England mortgage-interest deductibility was eliminated in 2000. Here policy has been targeted at households in debt and threatened with foreclosure as well as at support for investment and first-time buyers. In the Netherlands the focus is more on households who cannot sell their house and end up with two housing units for the time being. So far neither the economy nor the housing market has recovered in either country. Both are looking for new paradigms in housing and mortgage systems, in which risks are reduced for both households and banks.

Finally, Judith Yates (Australia) presents a view from a part of the world that, while initially badly affected by the financial crisis, was able to respond positively to limit instability and maintain a well operating finance system using already established regulatory mechanisms. Her contribution ‘Protecting housing and mortgage markets in times of crisis: a view from Australia’ discusses some key interventions in the Australian mortgage and housing markets prior to and during the financial crisis and brings out lessons about their impact on housing and mortgage markets.

4 Conclusions

Overall, this special issue presents a set of descriptions and analyses, which pay much attention to institutions and the context of development in national housing markets and national policy interventions. With the exception of the contribution by Kathleen Scanlon and Marja Elsinga papers are country specific but raise areas of comparison with other specific countries as well as more general issues about how to ensure longer term stability.

Equally, no elaborate theory is put forward to explain the differences in resilience of national housing systems in the face of the global financial crisis. Rather there are indications, as reflected in the spectrum set out in Table 1. More open systems appear to have been less resilient in this crisis (Iceland, the United Kingdom, the Netherlands), as have housing systems where supply had been particularly responsive (Spain, Ireland). On the other hand in Germany the relatively large share of the rented sector, seems to have acted as a buffer against shocks in the owner-occupied sector and the mortgage markets. In the Netherlands the relative strong position of housing associations with AAA financial opportunities has softened the impact on the construction market—as have stimulus packages in the UK, France and indeed Australia. However, longer term supply side subsidies, the most popular housing policy instrument after the Second World War, are no longer seen as an option in economically hard times, when national governments face the challenge of reducing public expenditure. Even so there are some limited signs of optimism in some countries’ proactive responses, notably with respect to taxation and regulation, which could lead to greater resilience in the longer term.

In many countries we observe policy reactions without a structured long-term view. In others we see the continuation of longer term housing policy reforms which limit the capacity of government to intervene more strongly. How these will develop is mostly still unclear, although the concern must be that affordability is likely to worsen, and access to mortgage funds will be more strongly regulated, while investment shows very limited signs of recovery.

It is too early to develop formal models even of the drivers of the links between the financial crisis and housing, let alone the outcomes because these are still unwinding and some essential empirical data are unavailable. The best that can be done at the present time is to monitor change and to set up hypotheses based on the comparison of experience and policy change. These form important topics for housing research programmes into the future. For housing researchers the current times are extremely interesting: the bigger the problems and uncertainties in national housing markets, the more challenging the life of housing researchers.

We are grateful for a number of referees who contributed with their reviews in a double blind procedure. They will be mentioned in the last issue of the *Journal of Housing and the Built Environment* of 2014.