

ENHR Conference

Workshop 2

Rotterdam, 25th June 2007

STUDY ON INTEREST RATE VARIABILITY

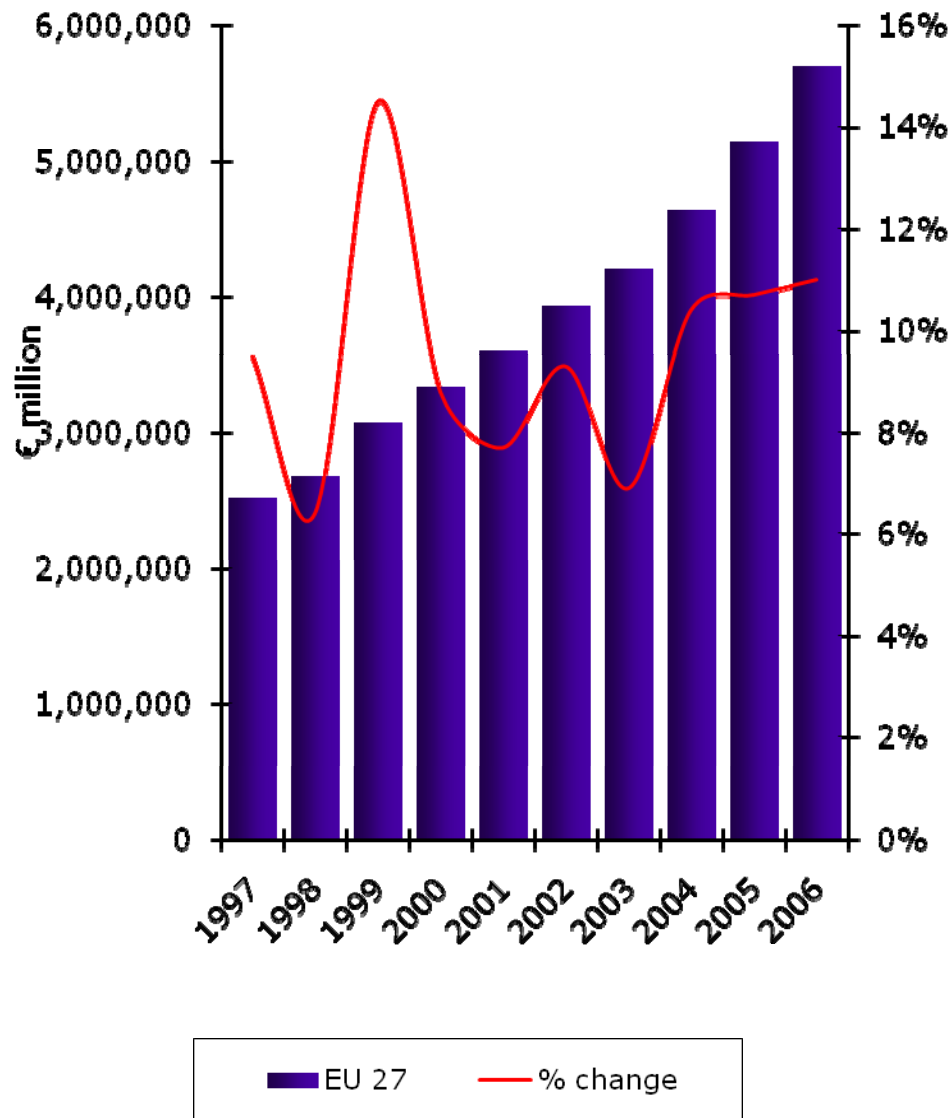
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European Mortgage Federation

Structure of Presentation

- **Market Trends: 1996-2006**
 1. Residential mortgage lending
 2. Mortgage market growth
 3. House price developments
- **Study on interest rate variability**
 1. Aim of the study
 2. Methodology and Definitions used
 3. Analysis
 4. Factors affecting variability
- **Conclusions**

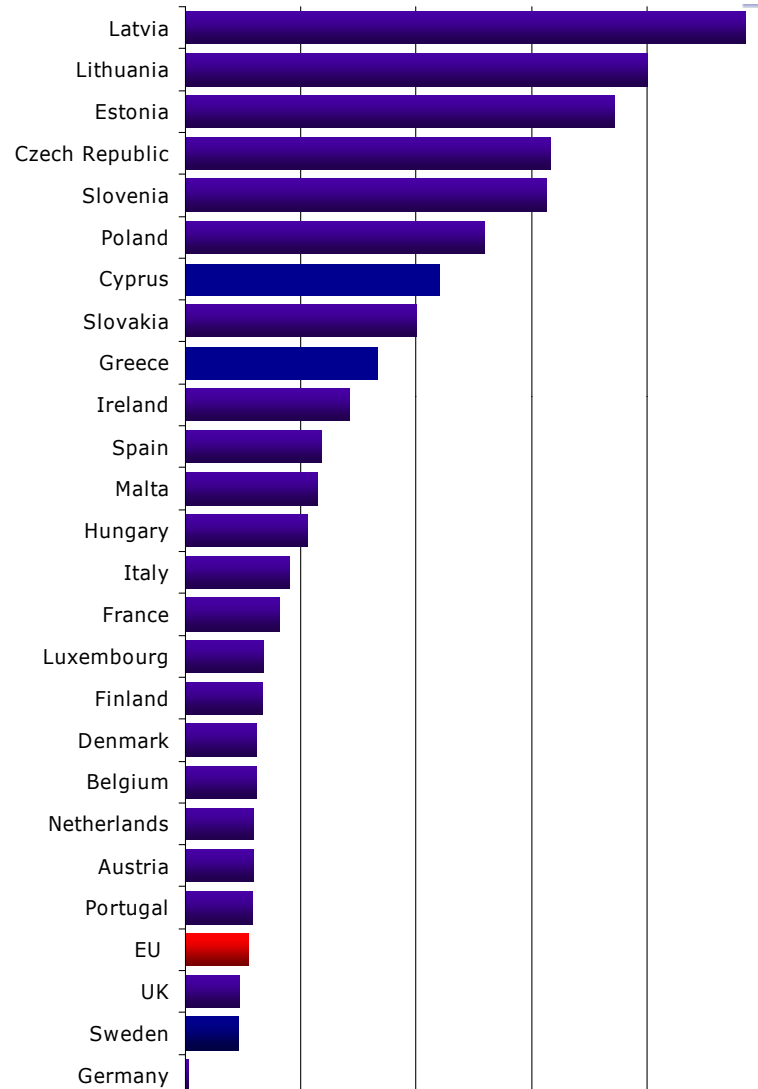
Value of EU Residential Mortgage Market 1997-2006



Source: European Mortgage Federation

- €5.7 trillion in debt outstanding as at end 2006 (EMF estimates)
- Growth rate in 2006 was between 11%-12%.
- Market has more than doubled in size over past 10 years.

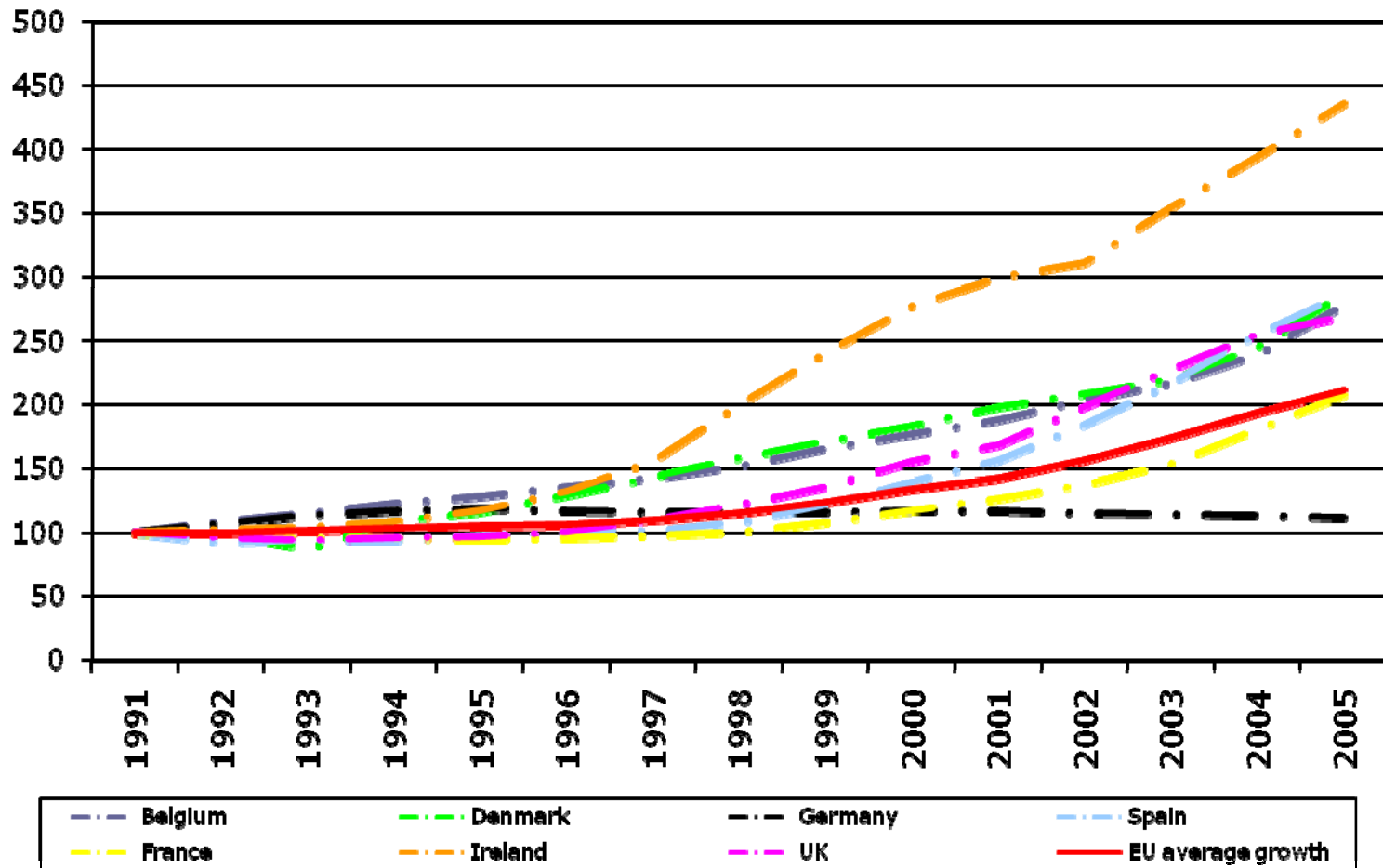
Mortgage Markets' Growth in 2005



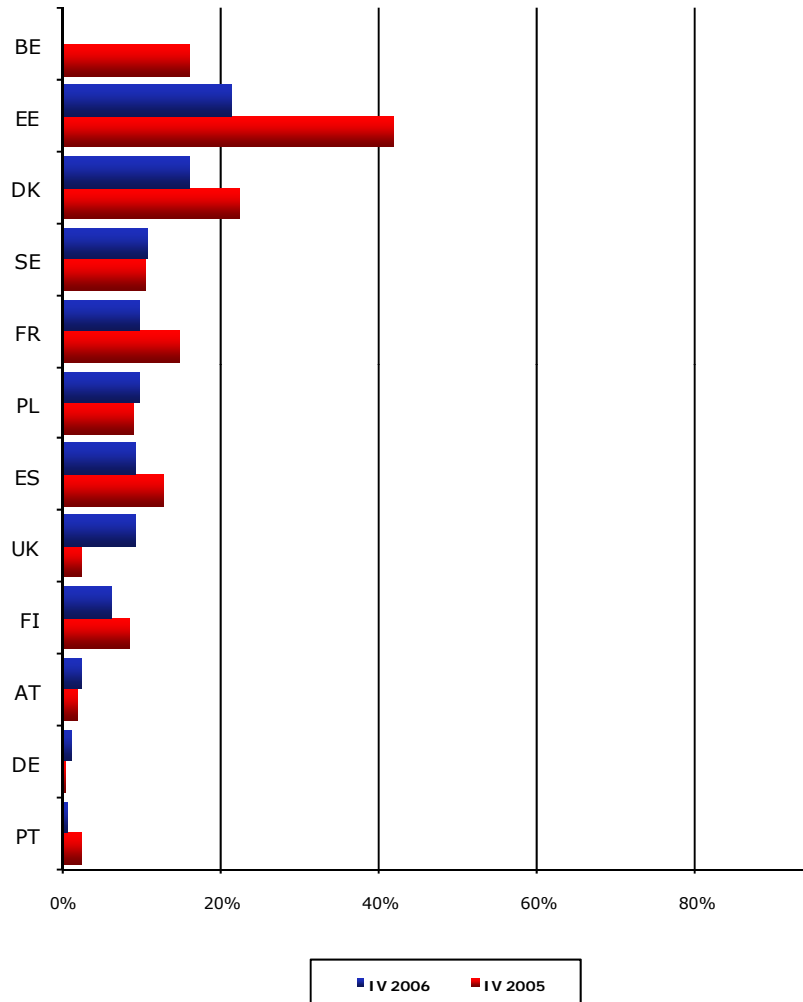
Source: European Mortgage Federation

- In the EU 25 the fastest growing mortgage markets are in CEECs; the fastest are in the Baltic countries.
- The fastest growing markets in the EU 15 are Greece (33.4%), Ireland (23.6%) and Spain (28.5%).
- Germany is still experiencing very low mortgage market growth (0.4%).

House Price Growth Rates in the EU 1991-2005



House Price Growth- 2005-2006



- House prices are growing at a two-digit pace, but a slowdown has become visible in some countries
- In a number of EU countries, DK, ES, FI, FR, LV and EE the house price growth rate slowed down in 2006.
- In the UK house price growth picked up again in 2006.

■ *Source: European Mortgage Federation*

The Study on Interest Rate Variability

Aim of the Study:

It is to provide an overview

- of the broad spectrum of interest rate types that exist in mortgage products offered across the EU
- of their development over the past few years
- and of the reasons for the underlying country differences

Analysis of data:

- Types of interest rates as a percentage of gross lending
- Types of interest rates as a percentage of lending outstanding

Methodology and Definitions

Interest Rate Sources

- Sources: National Central Banks, National Associations and CACI Mortgage data database
- Sources differ for i rates as a % of gross lending and % of outstanding in the UK. I rates as % of outstanding in the UK is from CACI Mortgage data database (used also from Miles review)
- Data for i rates as a % of outstanding was more difficult to find and most of the time the distinction is only between variable and fixed rates.

Interest Rate Categories

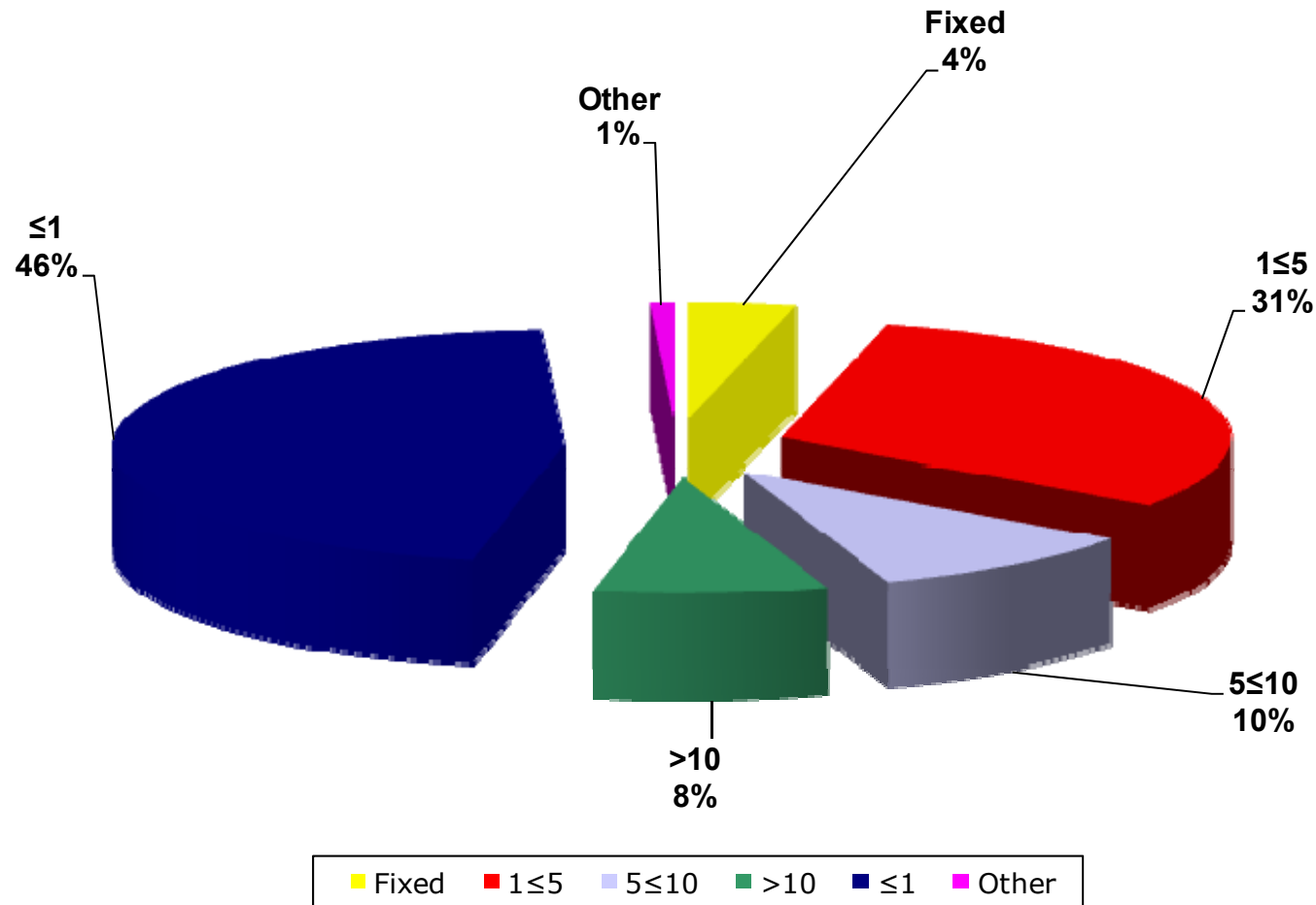
- Interest rate categories **differ** between countries. E.g:
 - 1) In **Ireland** categories from Bank of Ireland and FSA are 1) Initial fixed 1-3; 3-5; 5+ and 2) variable
 - 2) In **Belgium** interest rates fixed for a period less than 1 year do not exist.
 - 3) In **Denmark** there is a category for fixed rates. Fixed rate (annuity) loans are mainly based on long term interest rates dominated by 30 year rates (also by 20 year rates and to an even smaller extent by 10 year rates). The bonds behind the loans are callable annuity bonds.
 - 4) In **Sweden**, the category >10 years does not exist, the last category is >5. However, interest rates over 10 years are not common.

Definitions used in the study

- **Fixed rate:** it remains unchanged during the entire duration of loan. However, detailed data on fixed rate loans are available only for Denmark, Portugal and Spain. For the many other countries they are included in the initial fixed period rate category.
- **Initial fixed period rate:** The initial period of fixation is smaller than loan maturity and the initial fixed period is broken down into 3 categories:
 - 1) $1 \leq 5$ years
 - 2) $5 \leq 10$ years
 - 3) 10 years
- **Variable rate:** ≤ 1 year
- **Other rate:** accommodates hybrid products and new developments that do not fit into the other three categories

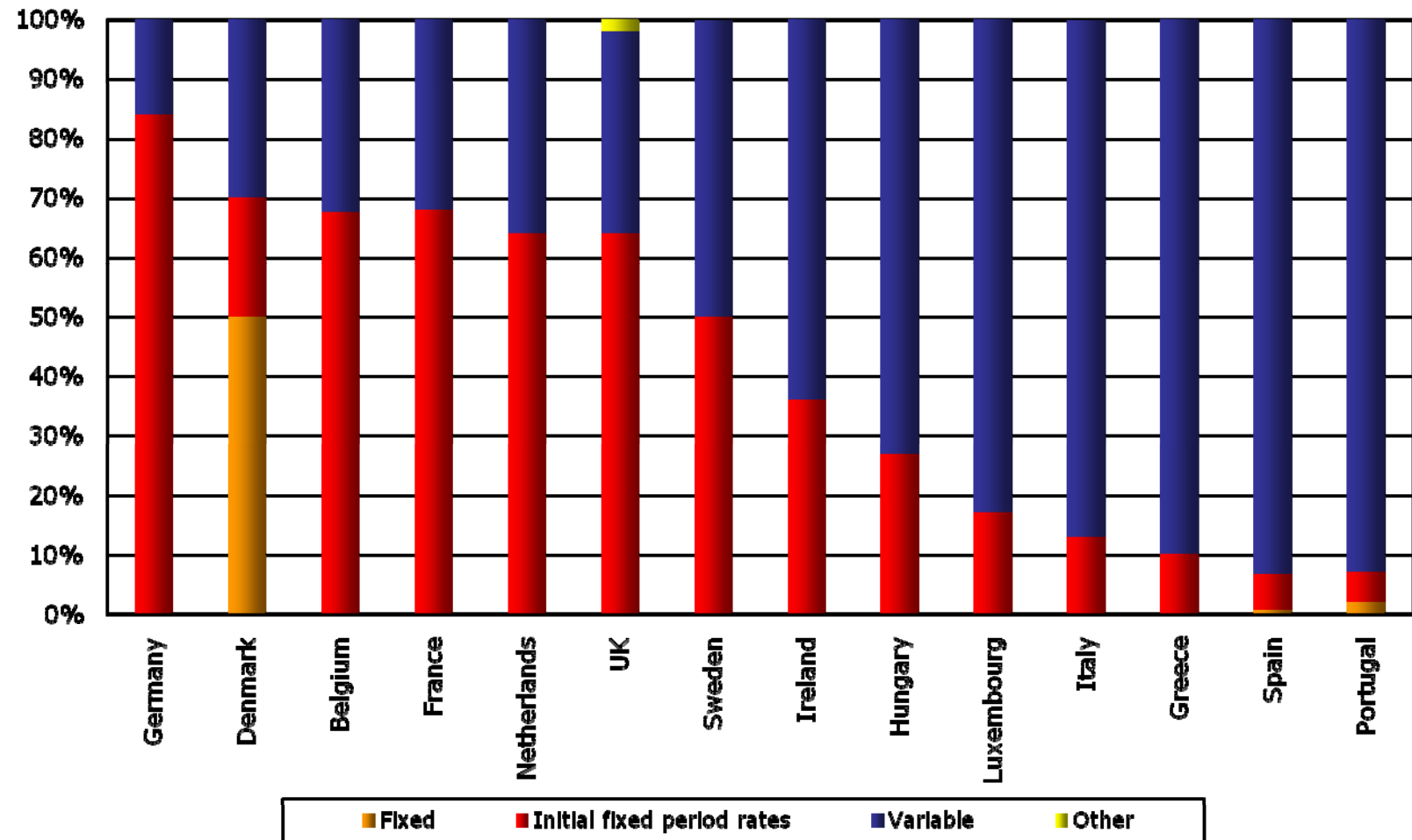
Analysis

Type of interest rate as % gross residential lending in the EU



Source: European Mortgage Federation National Experts, National Central Banks

Type of interest rate as % residential gross lending



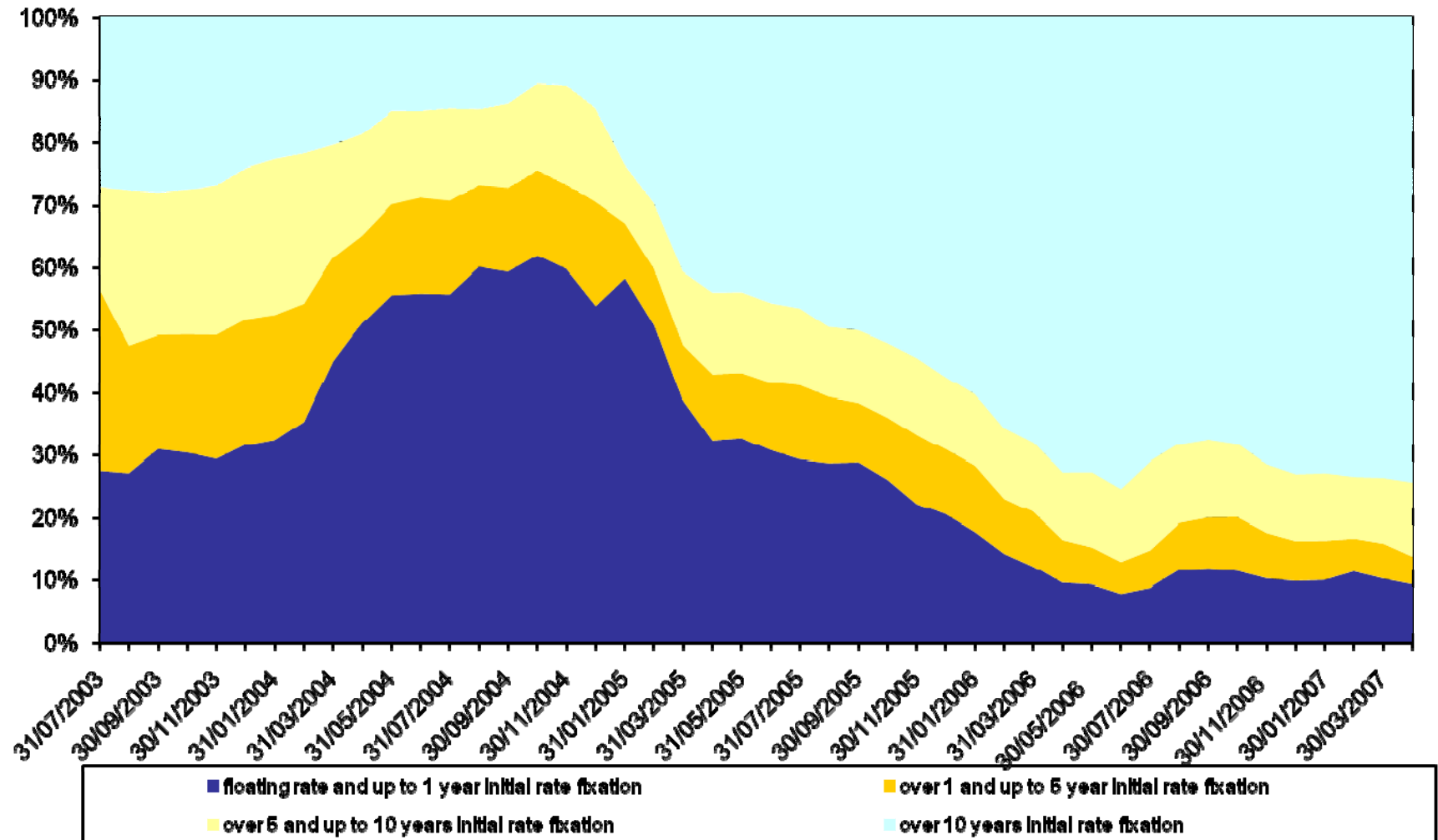
Source: European Mortgage Federation National Experts, National Central Banks

Note: Data for all countries are from 2005. Data for Italy, Netherlands and Portugal are from 2004

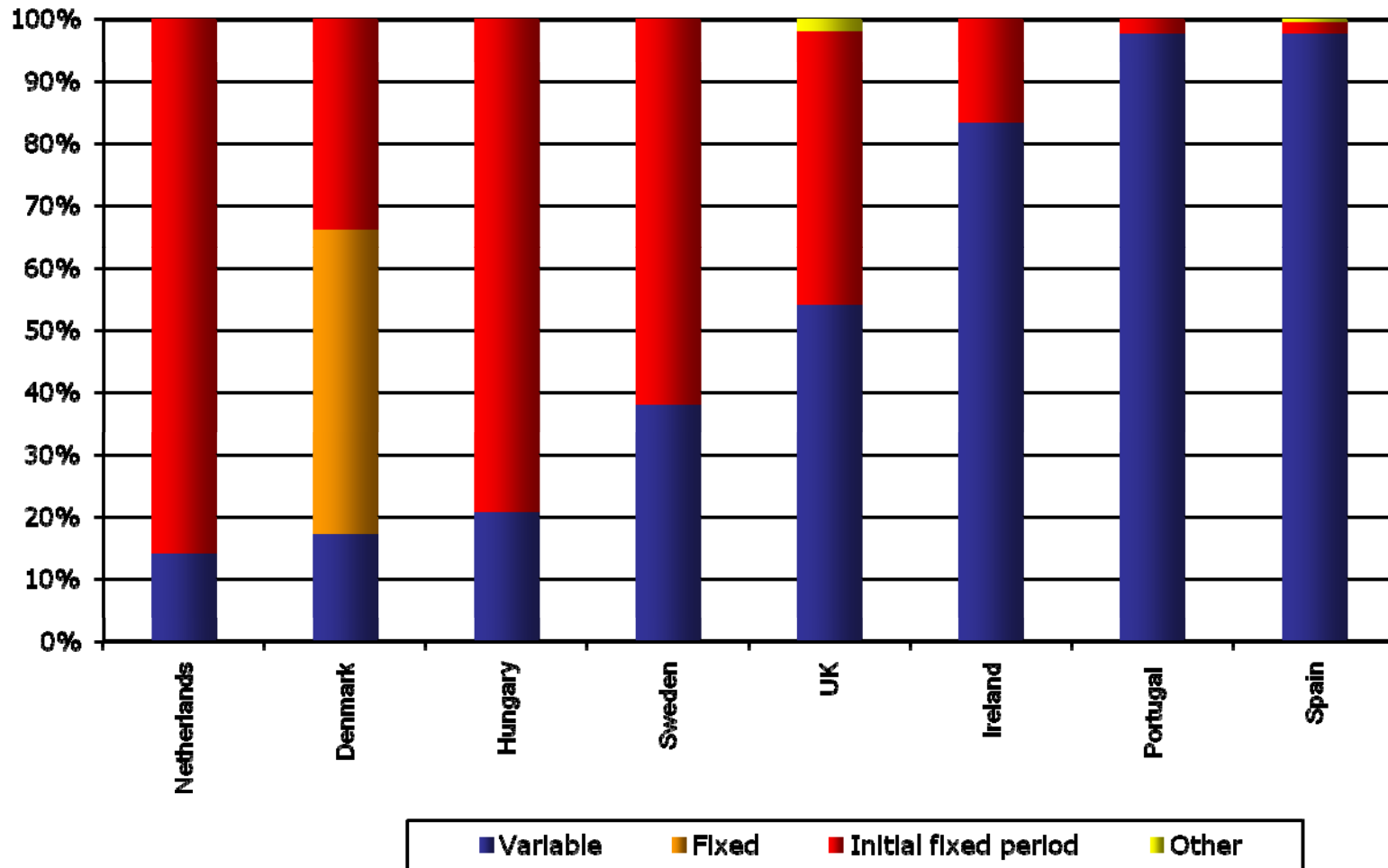
Type of interest rate as % gross residential lending in the EU

- The split between variable and fixed interest rates on new business can change very quickly.
- The changes are typically due to changes in relative costs of short term rates versus long term rates, as well as the introduction of new products onto the market.
- E.g. In Belgium due to the evolution of the yield curve and the introduction of the ("Accordion option"), variable interest rate mortgages increased significantly.

Types of interest rates as a % of gross lending in Belgium



Type of interest rate as % residential lending outstanding



Source: European Mortgage Federation National Experts, National Central Banks, for UK CACI

Notes: Data for all countries are for 2005; Data for Portugal are 2004.

Factors affecting interest rate variability

- **Cultural Habits:** E.g. in the UK people move up the “property ladder”. Flexibility of variable rates makes them more popular.
- **Yield Curve:** Slope of yield curve can change.
- **Early Repayment:** Strong consumer protection law which allows to repay at low cost any type of loan can affect interest rate variability.
- **Type of Funding:** In markets where covered bonds are widespread, fixed rate mortgages prevail.
- **Caps and Floors:** They can limit the extent to which interest rates can vary. E.g. In Belgium there are caps on interest rate increases during the first 3 years.
- **Euro:** The introduction of the Euro led to a decline in interest rates. E.g. In Italy lower interest rates and the introduction of covered bonds are expected to increase the share of fixed interest rate mortgages.

Conclusions

- Markets very responsive – mix of gross lending subject to rapid change
- Wide spectrum of products existing in Europe offering a range of variability options with the use of caps, floors, indices, various reset mechanisms, etc ...
- The study shows that around 53% of new business in Europe and 60% of outstanding is at fixed rates.
- Differences between countries can be explained by funding mechanisms, cultural preferences, early repayment rules, regulation, etc



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