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FINANCIAL INSTITUTIONS & ECONOMIC SECURITY (FIES)

POLICY BRIEF

Housing Security

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This policy brief has been produced for The Open University *Innovation, Knowledge, and Development (IKD)* Centre by Professor William Lazonick and Mr Öner Tulum with assistance from the participants in the IKD Conference on *Financial Institutions and Economic Security (FIES)* held in London, UK on 21-22 May 2009. The FIES conference considered the influence of financial institutions on employment security, retirement security, and housing security, as well as the interrelations among these forms of economic security in North America and Europe. The outputs of the FIES conference around the subject of *Housing Security* are summarised in this brief. For further information on the FIES project, working papers and upcoming events, please email: ikd-enquiries@open.ac.uk

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Financial institutions – such as investment banks, stock markets and hedge funds – have a major impact on employment, housing and retirement security and their policies can either support or undermine a person's ability to earn money, pay a rent or mortgage and meet the costs of retirement.

At the Financial Institutions and Economic Security (FIES) Conference held in London (May 21-22, 2009), researchers from around the globe explored the issues surrounding the 'financialisation' of the major Western economies and the implications for industrial innovation and stable and equitable economic growth.

Housing, as shelter, is a necessity. A major socioeconomic objective of modern societies is to provide good housing to as many people as possible. Access to good housing depends in large part on access to stable and remunerative employment. Good housing can be rented or owned. In general, the more that a society ensures the stable and remunerative employment of its labour force, the more feasible is the option of accessing good housing through rentals. Societies that have strong social welfare states tend to favour rentals over ownership.

Where home ownership is the norm, financial institutions become important to provide access to good housing through the provision of mortgages. Unstable and low-income employment eliminates the option of homeownership except under two very different conditions. One is strong state intervention, which can help underwrite the extension of mortgages to riskier households. The other, as in the case of the growth of mortgage lending that precipitated the United States "subprime" mortgage crisis, is for banks and other lenders to devise ways of profiting from the desire of people with low and unstable incomes to become – and then somehow to continue as - homeowners. State-supported arrangements are far more likely to result in stable home ownership over the long run, while, as we have seen in the recent financial meltdown and the subsequent foreclosures in the US, bank-promoted schemes can lead to disaster.

Housing security can decline for a number of reasons that are beyond the control of homeowners; for example, sharp interest rate increases on variable-rate mortgages, a sudden drop in income because of job loss, or a sudden decrease in cash savings because of medical emergencies. Under these circumstances, lenders may offer new financial products with features such as flexible payments, payment protection insurance, and sale-and-rent back schemes that promise to enable struggling homeowners to keep their homes. Yet, it may well be that, given the changed financial circumstances and vulnerability of the households concerned, these financial services do them a disservice by allowing them to hold onto their homes for a time while putting them in a deeper economic hole. Focusing on the case of the United Kingdom, Jonquil Lowe argues that there is a need for government regulation of these types of financial services.[1]

Financial innovation in the mortgage markets has also enabled homeowners to withdraw equity from their housing assets. As house prices appreciate and mortgages are paid off, homeownership can serve as a source of savings that may be important for retirement income. In the early 1980s, US financial services companies pioneered the 'securitisation' of mortgage assets (i.e. turning an asset into a tradable security) that made the accumulated equity in housing assets much more liquid than previously. Subsequently the extraction of housing equity has fuelled the growth in household consumption in Australia, Ireland, the Netherlands and the UK, as well as the US. A particular financial innovation in the US that emerged in the first half of the 1980s, subsequent to the securitisation of mortgages, was the home equity line of credit (HELOC), which enables a household to draw upon and repay a second mortgage as and when cash is needed. Households can use HELOCs as efficient and inexpensive tools of cash-flow management.

The easy access to funds that a HELOC provides creates the danger, however, that the household will overextend its ability to service its debt. In the 2000s low interest rates resulted in a dramatic increase in mortgage refinancing activities as well as housing equity withdrawal.

[1] Jonquil Lowe, "Financial Innovations and Mortgage Security", paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.

With the bursting of the housing bubble, many holders of HELOCs have seen the banks withdraw these lines of credit as the market value of their homes fell below the value of the total mortgages outstanding. In many cases, forced sales or foreclosures have been the result.

While the HELOC has been a popular mode of Mortgage Equity Withdrawal (MEW) among US homeowners, the attitudes toward and regulation of MEW in the forms of credit lines vary markedly across advanced nations.[2] Cross-national differences in welfare systems, regulatory approaches, tax regimes, and job market expectations explain the heterogeneity in financial arrangements for access to home equity. At one extreme is the American model which provides homeowners with easy access to utilising the equity from their properties at any time over the course of their lives, even if it may put their ownership at risk if circumstances change, or deplete savings that could have been available for retirement. At the other extreme are many European nations such as Hungary and Germany that seek to ensure that home equity will be available for withdrawal only in the event of financial hardship or to support retirement.

Recent surveys show that most European homeowners see the reverse mortgage form of MEW as a last resort for coping with their financial needs as their retirement annuities decline.[3] Nevertheless, European states that have low pension arrangements or high potential for housing value appreciation still encourage retirees to use reverse mortgages to draw upon their housing assets to help provide income in old age.[4] In both the United States and Europe, therefore, there has been a growing tendency to look to the equity built up in owned homes to help fund retirement, although with very different financial arrangements for and attitudes toward tapping into this equity.

Across all nations, however, the economic foundation for both buying a home and holding onto it into retirement is stable employment. Given unstable labour markets, it may become more difficult for young adults to become homeowners. Such, for example, is the case in France where low interest rates and tax incentives have enabled the wealthy to increase their investment in residential properties.[5] Despite the growth of residential housing in France, the vast majority of young adults cannot afford to purchase homes while a rising rent-to-income ratio is also creating housing insecurity for renters.

The best way for governments to deal with housing insecurity is to solve the problem of employment insecurity. Otherwise, over the long run, employment insecurity, retirement security, and housing insecurity will all rise in tandem.

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[2] Kostas Tsatsaronis and Haibin Zhu, "What Drives Housing Price Dynamics: Cross-Country evidence", BIS Quarterly Review, March 2004. A complete download available at http://www.bis.org/publ/qtrpdf/r_qt0403f.pdf
[3] Janneke Toussaint and Marja Elsinga, "Building and Consuming Housing Assets in 4 EU countries (Germany, Hungary, Nederland, United Kingdom)," paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.
[4] John Doling, Nick Horsewood and Peter Neuteboom, "An Alternative Approach to Pension Finance: the Case of Reverse Mortgages," paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.
[5] Claude Dupuy, "Financialization, Inequalities and Housing Crisis," paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.