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Housing support and public housing funds in Iceland and abroad

Considerable changes have taken place in the Icelandic housing market in recent years. Public sector involvement has changed and further reforms have been announced. It is interesting to examine these changes with reference to the way that public sector involvement in housing has evolved in neighbouring countries. The following is an account of the position and development of housing policies in several countries for which data are available. It compares different countries' government intervention in the housing market through the tax and welfare benefit system, and by direct intervention in the housing loan market. Iceland appears to provide less support through the tax and welfare system than neighbouring countries, but applies more direct intervention in the housing loan market.

Introduction

Economists and monetary and fiscal policy-makers have various reasons for scrutinising the housing market. It is influenced by economic developments and at the same time can have a considerable macroeconomic impact. Macroeconomic changes affecting the housing market are almost always reflected in changes in housing prices. Factors at work include actual or expected changes in household income, short-term real interest rates, population size and family structure. If housing supply does not manage to track such changes in the short term, imbalances may develop between housing supply and demand. Housing prices are also impacted by government measures, e.g. changes in taxation, subsidies and official housing policy. Variable supply of or access to finance can also have a substantial effect on demand for housing. In the

opposite direction, fluctuations in housing prices have a macroeconomic impact, in particular by stimulating lending and private consumption.

Central banks which are on inflation targets have ample reason to pay attention to the housing financing, due to its effect on the transmission of monetary policy.² Changes in housing financing arrangements cause an adjustment to a new equilibrium, and this process and its effects on monetary policy transmission and price stability need to be analysed.

Housing finance arrangements can have a direct impact on inflation measurements through the housing component of the consumer price index (CPI), which can vary depending on whether housing is predominantly owner-occupied or rented. Since Iceland has a relatively large proportion of owner-occupancy, housing prices weigh quite heavily in the CPI on which the Central Bank's inflation target is based, while rent is less important compared with other countries. Most other countries have a lower level of owner-occupancy and in some cases housing prices

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2. See Pétursson, Thórarinn G., "The transmission mechanism of monetary policy", *Monetary Bulletin*, 2001/4, pp. 62-77.

are not incorporated into the CPI on which their respective monetary policies (inflation targets) are based.³

Major reforms have been made to housing arrangements in Iceland in recent years, in most cases affecting the mortgage market. Recently the government has extended the sphere of operations of the Housing Financing Fund (HFF) and made efforts to expand its activities.⁴ It is interesting to examine whether housing arrangements are evolving in the same direction in Iceland as in neighbouring countries. A comparison has therefore been made with the following countries: Denmark, Finland, France, Germany, the Netherlands, Norway, Spain, Sweden and the UK. A snapshot of the current state of the housing market in these countries is given by the key figures shown in Table 1. Housing prices have soared in many parts of the world in recent years, including

portion of GDP was highest in Iceland in 1998-2003, the rise in housing prices third highest in 1997-2003 and the rise in rent the highest over the same period. Mortgages as a proportion of GDP are also high in Iceland, but surpassed by Denmark and the Netherlands.

The following sections discuss the government's housing policy objectives and the main paths for achieving them. The scope of support in different countries is compared as far as data are available. Support for tenants in rented accommodation and owner-occupied households is discussed, focusing on support for homebuyers through the mortgage system in the countries where this is provided. Finally, the main characteristics of housing arrangements in Iceland are summarised, and the current position and developments in recent years are compared with those in other countries.

Table 1 Housing market highlights in selected European countries

%	Owner-occupancy ¹	Housing investment, average year-on-year change 1998-2003	Mortgages as % of GDP ¹	Average year-on-year change 1997-2003		
				Housing prices	Rent	Consumer prices (HICP)
Denmark.....	51	0.4	75	4.1	2.6	2.1
Finland	61	1.6	31	7.2	3.1	1.9
France.....	55	2.4	23	9.0	1.6	1.5
Germany.....	42	-2.7	54	0.0	1.1	1.2
Iceland.....	83	8.9	64	10.3	9.1	3.5
Netherlands	53	0.8	88	4.9	3.0	2.9
Norway.....	77	2.3	50	4.7	3.6	2.1
Spain	85	5.6	38	18.1	4.2	2.8
Sweden.....	61	6.6	48	6.4	1.3	1.6
UK.....	69	1.3	62	25	2.8	1.3

1. Most recent statistics. Sources: European Mortgage Federation, Eurostat, *RICS European Housing Review* 2003 and 2004, Statistics Norway, Statistics Iceland and Land Registry of Iceland.

some of the countries in the comparison. Iceland ranks among the countries with the sharpest upswing in the housing market. Housing investment as a pro-

Government housing policy objectives generally quite similar – including matching housing quality and location to local conditions ...

Government policy objectives for residential housing are generally fairly similar. In short, it can be said that government policy in all the countries in this comparison is for everyone to be able to live in housing that is fit for habitation. However, the definition of being fit for habitation varies from one country to the next. Building regulations are used to define qual-

3. For example, housing prices are not included in the Harmonised Index of Consumer Prices (HICP) in the European Economic Area.

4. See "Household debt and the planned extension of public housing finance", Box 2 in the Financial stability chapter of *Monetary Bulletin* 2004/3, pp. 40-41, and "Main changes in the housing market in 2004", Box 1 in the chapter on Economic and monetary developments and prospects, *Monetary Bulletin* 2004/4, p. 13.

ity standards and adapt housing to local conditions. For example, residential housing in Iceland must be capable of withstanding strong earthquakes, which is not a necessary provision in, for example, the UK. Some countries need to consider the location of housing with respect to the risk of mudslides, floods or avalanches, and so forth. In Iceland and Germany the emphasis is on owner-occupancy, which is less of a priority in France, for example. In Spain, official policy is to increase the share of the rental market, as discussed below.

... while social goals also play a major role

Some regulations serve social goals, e.g. laws and regulations on the rental market, which aim to ensure satisfactory housing for all. Spain attempted for years to safeguard the interests of lower-paid groups with stringent rules for the rental market, which have in fact recently been changed. Support for rental tenants is discussed below. In North and Central Europe, social aspects of housing design have been a particular focus. This includes rules on the size of housing relative to the size of families – the number of members in a family is taken into account when social housing is allocated. Rules also apply to rent benefit. In Iceland, rent benefit is means-tested and intended to relieve the burden on less well-off households. Specific rules govern the allocation of rent benefits, for example they are not awarded for residential housing in industrial premises, or if kitchen and sanitary facilities are shared.

Social goals are generally attained through the tax and benefit system

To a large extent, governments have attempted to attain their social goals for housing through the tax system, i.e. tax allowances, subsidies and outlays on housing. The table in the Appendix presents a detailed overview of the tax and benefit systems of several European countries, which gives some idea of how governments can use them to influence the housing market. The main categories in the table are discussed below. Housing policy is rarely implemented by direct government intervention in the mortgage market. No other country in the comparison applies public support through the mortgage system on the scale witnessed in Iceland, as discussed in more detail below. Lending policy at Iceland's HFF has

increasingly performed a social role, spearheaded by the second mortgages available to lower-income families in addition to its ordinary housing loans. Besides Iceland, only Norway and France have public sector credit institutions that provide mortgages. Norway's *Husbanken* mainly lends for new housing, but also has a role in providing social support. For example, the bank is intended to assist low-income households, seniors and people with disabilities in acquiring satisfactory housing. This support is provided on a considerable scale: Norway's 2002 budget allocated 5.45 b. NOK to Husbanken to provide grants and benefits to assist lower-income groups, and 13 b. NOK for lending. In France, a range of public assistance is provided through the mortgage system. The most common is a dedicated savings scheme, but efforts are also made to contribute to lower interest rates on mortgages from credit institutions. Various loans are available to civil servants, and through the welfare system low-income households are offered loans at 0% interest. Arrangements for public support through the mortgage system in these three countries are described below.

Scope of public housing support through the tax system

Both the form and the extent of public housing support varies from one country to the next. In some the focus is on support for homeowners, and in others for rental tenants. The extent to which social support⁵ is connected with housing varies as well.

Table 2 presents an overview based on recent data from the European Central Bank (ECB), OECD and Nordic Council of Ministers for the scope of public expenditure on housing policies. Although harmonised data were not available for all countries, these figures should still provide an indication of where Iceland stands in this respect. The table indicates that Iceland has one of the lowest levels of public support for housing (generally based on social principles) compared with the countries in the OECD and ECB surveys. Iceland also has one of the lowest levels of housing taxes, and of support net of taxation. It should be reiterated that this comparison is confined to support through the tax system. No

5. "Social support" refers to support aimed at assisting lower-income individuals and households and improving their circumstances.

Table 2 Public expenditure on housing policies as a % of GDP

% of GDP			Nord 2001:27		
	ECB 2000	OECD 1998	Housing support 1999	Taxes on housing 1999	Support net of taxes 1999
Denmark	1.4	0.72	2.67	1.35	1.32
Finland	1.2	0.38	1.32	0.13	1.19
France	1.1 ¹	0.92	...	...	...
Germany	0.9	0.18	...	...	...
Iceland .....	...	0.12	0.87	0.50	0.37
Netherlands	0.7 ¹	0.44	...	...	...
Norway .....	...	0.20	0.80 ²	0.72 ²	0.80 ²
Sweden	1.4	0.81	1.74	0.93	0.81
UK	0.6	1.61	...	...	...

1. Data on allowances are from 1999. 2. Data on tax revenues from 1998. Sources: ECB March 2003, OECD, Social benefits, Nordic Council, Nord 2001:27.

allowance is made for the HFF and its activities in the OECD or Nordic Council data – through its state mortgage loan system, Iceland provides one of the highest levels of public support in Western Europe and indeed in the western world.

Central and local government shares in housing support

In Iceland, housing support largely consists of interest relief, rent relief and interest rate subsidies. Interest relief and subsidies⁶ are provided by the state, and rent relief by the municipal authorities. Rent relief amounted to 0.9 b.kr. in 2002 and interest relief 5.1 b.kr. The state therefore accounts for a much larger share than local government in Iceland. The same is true of Finland, where the municipalities' share is negligible. In Denmark just over one-quarter of support is provided by the state and remainder by local authorities. In Germany, on the other hand, only one-quarter is provided by the federal government, just under one-fifth by municipalities and the remainder by regional Länder. This difference may be connected with the fact that Iceland has one of the highest proportions of owner-occupied housing and Germany the lowest. As a rule, the division between public housing expenditure appears to be that central government

provides interest relief and tax relief, while local government provides support for rental tenants and generally also handles social support. Germany's low owner-occupancy rate, coupled with the absence of interest relief and tax relief, largely explains its different mix of support between central and local government, compared with Iceland.

In presentations of central and local government expenditures in the terms used here, it should be borne in mind that single-year comparisons may be misleading, especially in countries with variable mortgage rates. Interest relief and tax relief on mortgages may change year-on-year in step with interest rate changes. Since interest rates in the euro area were low in 2002, it can be assumed that the share of support provided by the state was exceptionally low in Finland, where 97% of mortgages carry variable interest rates. Hence the respective shares of central and local government in housing support are variable. This factor has less effect in Denmark, where only 15% of mortgages carry variable interest and 10% a mix of fixed and variable rates. Systemic changes that have a permanent effect on interest rate levels can also alter the relative shares of central and local government support, e.g. a cut in interest rates in Iceland will reduce interest relief but be offset by an increase in mortgage lending.

6. Interest rates on earlier types of HFF loans were subsidised. In the HFF's annual statements for 2002, the Treasury's contribution for interest rate subsidies was reported at just over 70 m.kr. This support is therefore negligible, the remnant of a previous housing loan system.

Support for households in rental accommodation

Support enables lower-income families and individuals to live in rental accommodation. Families living in unsatisfactory housing are helped in moving to better or larger dwellings. Support for rental tenants also brings people into the rental market who would otherwise not have the opportunity or incentive to do so (e.g. students living in their parents' homes and tenants who defer buying their own housing on account of favourable welfare benefits). In many countries the main channel for social assistance is in the form of support for rental tenants.

Table 3 Residential housing by category

	% of total residential housing ¹				Year
	Owner-occupied	Private rental	Social rental	Other or unknown	
Denmark	51	26	19	4	2001
Finland	58	15	16	11	2000/2001
France	54	20	18	8	1999
Germany	43	47	10	...	1999
Iceland ²	83	...	...	17	2003
Netherlands	53	12	35	...	2000
Norway	74	...	...	26	2001
Spain	85	9	2	4	1999/2001
Sweden	60	20	20	...	1995/2000
UK	69	10	7	14	2001

1. '...' indicates that a breakdown of data is not available. 2. The breakdown of rental accommodation between social housing and the private sector market is not available. Sources: Statistics Iceland, *Housing Statistics in the European Union 2002*, RICS *European Housing Review 2004*, *The Housing Market in Spain*.

Table 3 shows the breakdown of residential accommodation by category in the selected countries. The ratio of owner-occupancy varies, being lowest in Germany and highest in Spain. It is interesting to examine the causes of this wide discrepancy. Can it be traced to varying degrees of housing support, or is the underlying reason differences in legislation?

Data on the breakdown between support for rental tenants and homeowners are not easy to obtain and the information that is available often gives an imprecise picture of the real support. Housing support may be linked to size of family, income or other factors. In such cases, differences in the age composition of population can produce apparent differences in sup-

port, even when similar rules apply. In most of the countries, younger people tend to live in rental accommodation and older people are owner-occupiers. Younger people often have unreliable sources of income, e.g. they are still in education, are unemployed more often and want to travel before tying themselves to a specific place by buying housing. Furthermore, saving for a down-payment on housing generally takes some time. The following analysis is confined to arrangements in the three countries on the extreme in Table 3: Germany, where the owner-occupancy rate is lowest, and Spain and Iceland where it is highest.

Germany

Germany has a strong rental housing market. Only 41% of residential housing is owner-occupied, other housing is classified as rental and some is vacant. Conditions differ between West and East Germany. In Berlin, for example, only 10% of housing is owner-occupied, while the ratio in the Saar state is highest at almost 60%. Vacant dwellings are more predominant in East Germany. Almost one-fifth of rental housing in East Germany is social.⁷ The reason for the high share of rental housing in Germany compared with the rest of Western Europe probably lies in the levels of support for families in rental and owner-occupied housing respectively. As in other countries, older people in Germany tend to be owner-occupiers and younger people rental tenants. Official housing policy in the 1950s-1970s tended to encourage people to live in rented accommodation. Some impact still lingers from the unification, when there was an exodus from east to west and strong excess demand for housing was met with public support for rental market agents. Rental market regulations make long-term tenure very favourable for tenants, because rent is not determined by new agreements, but by a cross-section⁸ of the rent for comparable dwellings. As a

7. *Housing Statistics in the European Union 2002*, RICS *European Housing Review 2004*.

8. Rent is fully negotiable at the start of an agreement, but subsequent changes are regulated, and generally indexed either to inflation or to market rent for comparable housing. The index for comparable housing is based on average rent at any time. Only new rental agreements can affect the average rent for each respective category of housing, together with earlier agreements that are cancelled. For this reason, rent is inelastic and lags behind the market.

result, increases in existing rent lag behind the market rate, making tenants reluctant to change their housing arrangements. Landlords may be tempted to counteract this by setting the rent on new agreements higher so that new tenants bear the brunt of market rents when they go up. However, this has not been a problem in recent years, since strong supply of rental housing, weak demand and low inflation have kept rises to an insignificant level.

The German government is aiming for a higher level of owner-occupancy. It supports homebuyers with tax relief based on the value of the housing in the year of purchase, but unlike most EU countries does not grant relief for mortgage-related interest payments. Germany also waives landlords' debts with the public sector if they sell at least 15% of their rental housing to tenants. But several temporary factors constrain growth of owner-occupancy, in addition to the temporary support provided to the rental market in connection with unification. Germany's economy has been depressed in recent years, accompanied by unemployment, sluggish private consumption growth and higher taxes. Relatively high real interest rates on mortgages have also dampened housing demand.⁹ Supply of new building land has been limited due to the reluctance of local authorities to plan and develop new residential districts.

The interaction of government policies over the past few decades, the temporary impact of reunification and the recent economic climate are probably the main causes of Germany's notably low proportion of owner-occupancy.

Spain

Spain has the highest level of owner-occupancy in the EU. A survey of consumption conducted by the Spanish Statistics Office¹⁰ in 2001 revealed that 84.7% of residential housing was owner-occupied, 9.3% rented and 6% vacant.¹¹ No single reason can be identified for the high level of owner-occupancy.

9. In 2002 nominal interest rates (fixed for at least 10 years) averaged 5.8% and year-on-year inflation was 1.3% (HICP), leaving interest rates at around 4½% in real terms.

10. Martínez, Jorge and M^a de los Llanos Matea, Banco de España Research Department.

11. These figures apply to residential housing that is occupied year-round, not holiday homes.

Under earlier rules on the rental housing market, tenancy was inherited and rent could only be raised after demonstrating that housing costs had increased. As a result, new rental housing was in short supply, and rented accommodation in general difficult to come by. Rental market regulations were liberalised in 1985 but without a grandfather clause for existing agreements. Thus the Spanish rental market is divided into two parts. One comprises a relatively fixed number of long-term, low-rent agreements, and the other short-term agreements at much higher rent. Demand for rental housing covered by the new regulations is very subdued. Part of the explanation for the high level of owner-occupancy may be cultural: the tendency for extended families to live together. In the mid-1990s there were 3.3 persons in the average household; 44% of males and 30% of females under the age of 30 still lived with their parents, and only 5% of the 65+ group lived alone. High unemployment and lack of social housing also prevented young people from being able to afford to leave home. In recent years, Spain has been attempting to increase the share of rental housing. The tax advantage of owner-occupancy was reduced in 1999 and legislative reforms last year aim to stimulate the rental market. However, low real interest rates,¹² stiff competition in the mortgage market and the buoyant Spanish economy have caused the owner-occupancy rate to rise from 76% in 1985 to almost 85% in 2001.

Iceland

It has been government policy in Iceland to encourage home ownership. Much more funds have been allocated to promoting general home ownership than to boosting the rental market. Planned changes in HFF lending rules to raise the loan-to-value ratio to as much as 90% support general home ownership further still. Plans are also afoot to abolish net wealth tax, but this will be offset by a planned reduction in interest relief.¹³ However, support for the rental market was stepped up with a regulation issued in 2001

12. Interest rates remained low in real terms due to low nominal rates, variable interest rates of approx. 4.5% in 2002 and high inflation measuring 3.6% (HICP) year-on-year. The real interest rate was therefore just under 1%.

13. Cf. the parliamentary bill amending Act no. 90/2003, on Income Tax and Net Wealth Tax, as amended, and other legislation.

authorising the HFF to lend for construction of rental accommodation. Loans may amount to up to 90% of construction cost or purchase price of housing, with a maturity of up to 50 years. Rent relief is means-tested and therefore relatively small in scope, and the rental market is not large. Rented accommodation owned by the public sector (mainly local authorities) is in short supply and solely used by the social services or for municipal employees. In regional Iceland, it is common for local authorities to own housing occupied by their employees such as teachers.

Another difference in the rental market between Iceland and most countries in the comparison is that very few landlords own housing that is specifically intended for renting out. Rental accommodation commonly belongs to people who are temporarily resident elsewhere, for example when studying. As a result, rental agreements tend to be fairly short-term, most often for one year, and a tenant rarely stays in the same housing for longer than five years. Because agreements are short-term, rent moves in close step with housing prices. This makes it less economical to rent during episodes of housing price inflation than in countries where rental agreements are longer-term, rent lags behind housing prices and rent increases are more stringently regulated. However, it should be mentioned that some rental accommodation has been built in Iceland following a new regulation set in 2001.¹⁴ Increased supply of rental housing should contribute towards longer-term rental agreements. Time alone will tell whether sufficient rental accommodation will be built and sufficient demand will be at hand to increase its share in the housing market.

Support for owner-occupants

People need to consider various factors when deciding whether to buy rather than to rent housing. A buyer must be able to meet the instalments and preferably be able to sell the housing without much cost or other problems. Capital formation is another consideration, because households invest a large share of their life savings in housing.

Public support for owner-occupancy is most commonly provided through tax relief on interest pay-

ments or direct interest relief. In this way the general government helps homebuyers over the first and most difficult hurdle, when the principal of the loan is highest and interest payments heaviest. Over time the principal decreases and the interest payments burden eases. The table in the Appendix shows that most countries provide some kind of interest relief or tax relief. Only the UK,¹⁵ France and Germany do not support owner-occupants in this way.

Tax relief on interest payments is the more common arrangement for support. However, it benefits only employed taxpayers. Iceland's interest rebates are means-tested, so it is not least the unemployed and low-income groups who benefit from them. Interest relief is by far the largest single component of public housing support in Iceland and is much greater than rent relief. Overall, as Table 2 shows, the scope of public support in Iceland is fairly small by international comparison.

It should be pointed out that although the UK provides neither tax relief on housing nor mortgage interest relief, social support is provided in connection with interest payments for people in difficult circumstances such as unemployment or illness. Such assistance is provided only when unpaid mortgage interest has accumulated for several months. The government will then settle the interest due, but does not remit the sum to the payer. Also, assistance is confined to homebuyers who have not insured themselves against mortgage delinquency.¹⁶ Such insurance policies are offered in other countries, including Iceland recently.

Housing transaction costs vary from one country to the next (see table in the Appendix). Iceland has relatively low housing transaction costs. On signing the purchase deeds the buyer pays stamp duty equivalent to 0.4% of the valuation of the property. Stamp duty is equivalent to 1.5% of the nominal value of new borrowing and thus amounts to around 1.2% of the market value of a property if an 80% new mort-

14. The aim of this regulation is to facilitate local authorities and housing associations in increasing rental housing supply. It largely appears to constitute a form of social assistance.

15. Support through interest relief was in effect in the UK, but was abandoned because the government felt that households too frequently spent interest rebates on consumption instead of their mortgage payments.

16. In the UK, mortgages are provided in the private market with the property as collateral. Homebuyers can insure against delinquency due to circumstances beyond their control, such as unemployment or illness, in which cases the insurance fund meets the mortgage interest payments.

gage is taken. Loan registration fees are 1% of the nominal value of HFF bonds and 0.5% of supplementary loans (second mortgages), nominal. Public costs on housing transactions are highest in the Netherlands and Denmark and lowest in Iceland.

A higher capital income tax than the capital gains tax on housing¹⁷ encourages housing investment. This applies in Iceland and the countries surveyed here.¹⁸ In most countries homebuyers are exempt from capital gains tax on housing that they have occupied for two years or longer. In the Netherlands there is no capital gains tax on housing.

People deciding whether to buy or rent housing also need to take into account real estate tax and tax on owner-equivalent (imputed) rent. Real estate tax appears broadly similar in the surveyed countries and can be ignored. Tax on owner-equivalent rent, i.e. on the economic benefit of owner-occupancy over and above paying rent, is levied in Denmark, Norway, Sweden and the Netherlands, but not Iceland. Research has shown that it is primarily homeowners who have paid off their mortgages who benefit more from living in their own housing than in rented accommodation.¹⁹

Support through the mortgage system

No other Western European country provides public support for homebuyers through the mortgage system on the scale operated in Iceland. Of the countries in this comparison only Norway and France provide public support through the mortgage system. Elsewhere it has increasingly been provided through other channels. Developments in Western Europe have been characterised by privatisation of banks that provide mortgages and a market-oriented legal environment for the activities of housing credit institutions. Examples include deregulation of loan ceilings and interest rates, lower prepayment charges, etc.²⁰

17. "Capital gains tax on housing" refers here to tax on the margin between the buying and selling price of house caused by an increase in the price of the property over the period of its ownership.

18. Such an incentive exists even in Sweden, where capital gains tax on housing is 25%, because capital income tax is higher, at 30%.

19. Frick, J. R. and M. M. Grabka, January 2002.

20. See Appendix 2, "Public support for homebuyers in Iceland and elsewhere", to the section on Economic and monetary developments and prospects, pp. 45-47, *Monetary Bulletin* 2003/4; and ECB, *Structural factors in the EU housing markets*.

The following is a brief outline of the main aspects of mortgage arrangements in two countries which, along with Iceland, provide public housing loans.

France

In France, homebuyers are provided with a variety of public support through the mortgage system. The following account is confined to the main types of public mortgage loan. The public housing savings scheme (*plan d'épargne-logement*) has been used for the purchase of 40% of owner-occupied housing. Under this scheme, potential homebuyers save a specific sum for at least 5 years at below the market interest rate. They can then borrow 2.5 times the accumulated saving at below the market interest rate, and use the amount already saved as a down-payment. Public involvement in the mortgage market also follows other channels, e.g. with regulations on private sector mortgages. Among them are the regulated loan scheme (*prêt conventionné*) for public sector institutions and lenders, which contributes to lower interest rates than in the private market. Zero-interest mortgages are also provided by the state in France for low-income families.

Norway

Husbanken in Norway is a public loan provider for homebuyers. At the end of 2002 Husbanken accounted for 14% of outstanding mortgages in Norway. While Husbanken also lends for first-time mortgages and renovation and performs a social role, as mentioned above, its largest lending category by far is for new housing, subject to regulations on layout and size. Husbanken lends for the lion's share of all new housing and in effect its rules for allocation shape housing design trends in Norway.

Husbanken is state-financed with funding on the budget approved by the Norwegian parliament, which also covers grants and operating costs including loan losses.

Iceland

The Housing Financing Fund (HFF) dominates Iceland's mortgage market. At the end of 2003 it accounted for more than 75% of outstanding lending for housing. It lends both to social housing and the private market, and for construction of new housing and secondary market purchases. The HFF grants

secured mortgages for low-income and low-asset households at a loan-to-value ratio of up to 90%, 70% of collateral to first-time buyers and 65% to others. The maximum loan amount is 11.5 m.kr. In recent years the government has eased the HFF lending rules in various ways. The maximum loan amount was increased in two steps from 8 b.kr for secondary market purchases and 9 b.kr. for new-buildings in 2003, to 11.5 b.kr. towards the end of 2004; the maximum mortgage-to-fire-insurance ratio was 85% until October 2004 when it was raised to 100%; and it has been decided to raise the maximum loan-to-mortgage ratio to 90% at the beginning of 2005. Presumably the government has eased the HFF's lending rules faster than originally planned after the commercial banks began offering more favourable mortgage terms than it had provided.²¹ As soon as a private sector market evolved, the HFF was set into competition with it.

The HFF also lends for construction of rental housing, as mentioned above.

The relation between housing debt and the support associated with it

It is interesting to examine whether there is any relation between housing debt and the form or extent of support associated with. In this context, public lending for housing purchases can be compared with support in connection with interest payments.

Only France, Norway and Iceland provide public loans to homebuyers. The owner-occupancy rate is higher in these countries than the others in the table, at 72% against 60%. Nonetheless, the average mortgage-to-GDP ratio is higher in the countries that do not provide public mortgage loans, at 57% against 46%.

The UK, France, Spain and Germany do not provide tax relief or interest relief on mortgage debt. The mortgage-to-GDP ratio is much lower in these countries than elsewhere. Interest relief, however, does not seem to have such a strong effect on owner-occupancy rate.

On first impression, public loans to homebuyers would seem to promote more widespread housing

Table 4 Public support connected with mortgages, and mortgage ratios

	<i>Mortgage-to-GDP ratio</i>	<i>Owner-occupancy ratio</i>
Denmark.....	75	51
Finland.....	31	61
France.....	23	55
Germany.....	54	42
<i>Iceland.....</i>	<i>64</i>	<i>83</i>
Netherlands.....	88	53
Norway.....	50	77
Spain.....	38	85
Sweden.....	48	61
UK.....	62	69
<i>Countries providing:¹</i>		
Public housing loans.....	45.7	71.7
No public housing loans.....	56.6	60.1
<i>Countries providing:²</i>		
Interest relief on housing.....	59.3	64.2
No interest relief on housing.....	44.3	62.8

1. Iceland, Norway and France provide public housing loans, the others do not. Averages. 2. The UK, France, Spain and Germany do not provide interest relief or tax relief on mortgage interest payments; the other countries do in one form or another. Averages. Sources: European Mortgage Federation, Statistics Iceland, Central Bank of Iceland.

ownership, and support for mortgage interest to increase indebtedness. It must be remembered that because this comparison is based on very few countries, it should be regarded only as a vague indication of these relationships. Changes to HFF lending arrangements and new injections of funding from the banks for housing purchases are likely to increase mortgage debt and thereby its ratio to GDP, besides the impact of indebtedness on consumption. Other things being equal, the reduction in interest relief ought to have the opposite effect.

Conclusion

The above is an examination of public intervention in the housing market in Iceland, compared with selected other countries in Europe. In terms of support for homebuyers through the tax and welfare system, Iceland has one of the lowest levels of government

21. See Box 1, "Main changes in the housing market in 2004", in the section on Economic and monetary developments and prospects on p. 13 of this edition of *Monetary Bulletin*.

intervention. Official housing policy in Iceland and many other countries is to enable as many people as possible to own housing of an acceptable standard. Iceland has achieved this objective well, with only Spain attaining a higher level of owner-occupancy. In recent years, however, efforts have been made to strengthen the rental housing market. It is still premature to evaluate the impact of those measures, and many other developments have had a counteracting effect, especially cheaper mortgages and easier access to them. The stated policy in Spain is to increase the share of rental housing, among other things to enhance mobility of labour. Owner-occupancy in Iceland is only slightly less than in Spain, but claims that the level is too high are rarely heard. On the contrary, the government's measures this year apparently aim to boost owner-occupancy from the current level.

Intervention in the housing market through the credit market is more pronounced in Iceland than any other country in the comparison. Besides Iceland, only Norway and France offer homebuyers public assistance with housing finance.

In both Iceland and Norway, public support for housing finance is handled by a single institution, but in Norway its scope is much more limited. Public support is transparent in these two countries and its scope is easy to appraise. France uses a number of channels for public assistance with housing finance, making its total scope difficult to assess. Nonetheless, it seems fairly certain that public support in France, where only just over half of housing is owner-occupied, is not as extensive as in Iceland. The increase in the maximum mortgage amount from Iceland's HFF, the raising of loan-to-value ratio to 90% (or 100% of fire insurance evaluation) and lower rates of interest will contribute to continued participation by the HFF in mortgage lending.

Undoubtedly, these changes will increase housing debt still further and help to maintain the HFF's sizeable share in the mortgage market despite recent competition from the banking sector. Iceland would appear to be on the opposite trend to France and Norway in this respect. To emulate these countries' position would call for a substantial cutback in HFF activities with more focus on social support, levelling out opportunities for homebuyers with regard to their income, geographic factors and conceivably new housing.

Easier access to cheap funding for the purchase and mortgage of housing in Iceland will probably have a sizeable macroeconomic impact. The chief effect will be increased consumption, which will become apparent in the near future. In the long run the development of housing prices and inflation will also be important. All classes of mortgage loans are price-indexed with a maturity of 20-40 years. If the increase in price level exceeds nominal housing price rises by more than the ratio of the housing that is not mortgaged, it is clear that part of the residential housing stock will be mortgaged beyond its market value.

A straightforward comparison of arrangements in the above countries indicates that public support in the form of mortgages leads to more widespread housing ownership, but not to more indebtedness than in countries where support is not provided through public credit agencies. Tax relief and interest relief, on the other hand, do not appear to contribute to greater owner-occupancy, but encourage higher levels of debt than in the countries that do not offer such allowances. The ongoing changes in Iceland (easier access to state credit and reduced interest relief) will probably serve to increase indebtedness, but given the limited scope for increasing owner-occupancy on any great scale, it is questionable whether this is desirable.

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Appendix Taxes, benefits and official charges on housing transactions¹

	Tax on imputed rent	Interest relief/ mortgage-related tax relief	Tax on capital gains on housing	Real estate taxes	Inheritance tax	Net wealth tax	Indirect tax		Stamp duty ²
							On repairs	On new homes	
Denmark	Y	Y	Y (exemptions for owner-occupiers)	Y	Y (same as for financial assets)	N	25%	25%	Stamp duty 1.5% – total trading costs 7.2%
Finland	N	Y (flat rate for principal owner-occupied dwellings up to a ceiling, 29%)	Y (exceptions for principal owner-occupied dwellings after at least 2 years)	0.2% of taxable value	Y	Progressive in wealth, 0% for most households	22%	22%	4% of purchase value (first-time buyers exempted)
France	N	N	Y (no tax for main dwelling)	+ residence tax: 7.8%-45% of half cadastral rental value	5%-40% (progressive)	0.5%-1.5%	5.5%	19.6%	2%-3%
Germany	N	N	Y (turnover < 10 years, exemptions for owner-occupiers)	N (land tax, 0.3%-1% of rateable value)	Lower than for financial assets	N	16%	16%	3.5%
Iceland	N	Y (interest relief)	Y (10% if housing is sold within 2 years and not refinanced in housing, otherwise none)	≤ 0.5%	10%-45% (progressive)	0%-0.6% (progressive in wealth, was 0%-1.2% in 2001)	24.5% (rebate of 60% of VAT on labour cost)	24.5% (rebate of 60% of VAT on labour cost)	0.4% of housing value, 1.5% on housing bond mortgage, 1% on HFF bonds and 0.5% on second mortgage

Appendix Taxes, benefits and official charges on housing transactions¹

	Tax on imputed rent	Interest relief/ mortgage-related tax relief	Tax on capital gains on housing	Real estate taxes	Inheritance tax	Net wealth tax	Indirect tax		Stamp duty ²
							On repairs	On new homes	
Netherlands	Y	Y	N	0.3%	5%-27% (on amount above tax-free threshold)	1.2%	19%	19%	6%
Norway	Y	Y (28% tax relief on interest payments)	Y (28% exemption if owner has been occupier for one of 2 years before sale)	≤0.7%	...	0%-1.1% (progressive in wealth)	Y	Y	...
Spain	N	Y	Y (exemptions for principal dwellings when reinvested)	0.62%	7.65%-34% (progressive)	0.2%-2.5%	15%	7%	...
Sweden	Y	Y	Y (25%)	0%-1.5% of 75% of the market price	Y	1.5%	25%	25%	1.5%-3%
UK	N	N	Y (exemption for principal owner-occupied dwellings)	0.2%	Y (same as for financial assets)	N	17.5%	0%	1%, 2%, 4% depending on value of housing

1. '...' indicates information not available. 2. Only duties on housing transactions, except for Iceland where the borrowing cost of HFF bonds and second mortgages from the HFF is included. Borrowing costs for private sector mortgages are excluded, since they are variable and also differ among institutions, making it difficult to state the most accurate figure for each country. Sources: ECB March 2003, Icelandic tax law, Nord 2001:27, Norwegian tax law.