Homeownership Rates: A Global Perspective

by Soula Proxenos

The rate of homeownership is often used as a measure of the quality of a country's housing finance system.[1] For example, it is often argued that the U.S. housing finance system is superior to the German system by virtue of the fact that there is a 27-percentage-point difference between American and German homeownership rates. Upon closer analysis this comparison encounters obstacles, because Mexico and India, where housing is inferior in quality and availability in comparison to the U.S. and Germany, both boast homeownership rates of over 80%.

This paper will argue that homeownership rates are not the only indicators of the quality of a housing finance system because they are not defined and measured consistently from one country to the next. It also demonstrates the impact of demographic trends and legal and government policy on homeownership in various countries. This paper will argue further that the quality of housing finance systems are more accurately compared in terms of the extent to which they minimize the cost of housing, improve access to funds, enable consumers to predict payment amounts, and allow borrowers to easily refinance.

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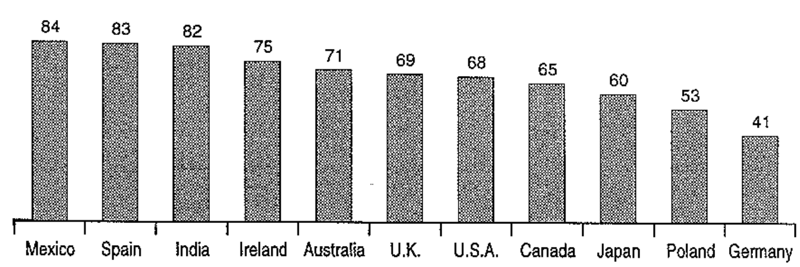
WHY HOMEOWNERSHIP RATES ARE NOT THE ONLY INDICATORS OF HOUSING FINANCE SYSTEM EFFECTIVENESS

The terms home and homeownership are not defined consistently worldwide. Among industrialized nations, definitions and measurement can significantly differ from one country to the next. In the U.S., for example, a housing unit is defined as a house, an apartment, a mobile home, a group of rooms, or a single room that is occupied as separate living quarters with a registered street address. In Canada, a private dwelling is defined as a set of living quarters designed or converted for human habitation in which a person or group of persons reside or could reside. In addition, a private dwelling must have a source of heat or power and must be an enclosed space that provides shelter from the elements, as evidenced by complete and enclosed walls and roof and by doors and windows that provide protec-

Figure 1. Homeownership Rates (percentage)



Sources and years of statistics: Spain's INEbase (1999); Ireland's Central Statistics Office (1998), Australian Bureau of Statistics (1998); UK's National Statistics (2001); U.S. Bureau of the Census (2002); Statistics Canada (1998); Japan's Statistics Bureau and Statistics Center (1998); Germany's Federal Statistical Office (1998); International Housing Finance Sourcebook 2000 for Mexico (1999), India and Poland (1990).

tion from wind, rain and snow.[2] According to Canada's definition, only four out of ten dwelling units in India, the units having so-called "permanent" facilities, would qualify as homes.[3]

In the United States, a housing unit is owner-occupied if the owner or co-owner lives in the unit, even if it is mortgaged or not fully paid for. In the U.K., long leaseholds are recognized as owner occupation even though the actual lease is owned by someone other than the homeowner.[4] In Japan, dwellings that are owned by parents of the households occupying them are also considered owned houses. The homeownership rate in the U.S. is computed by dividing the total number of households that are owners by the total number of occupied households.[5] The European Mortgage Federation defines the homeownership rate simply as the percentage of dwellings owned outright or purchased with a mortgage in relation to total dwelling stock. In the developed world, broad definitions are coupled with a comprehensive and robust land and titling infrastructure, which is more often than not absent in the developing world. In emerging markets, simply obtaining definitions can be difficult.

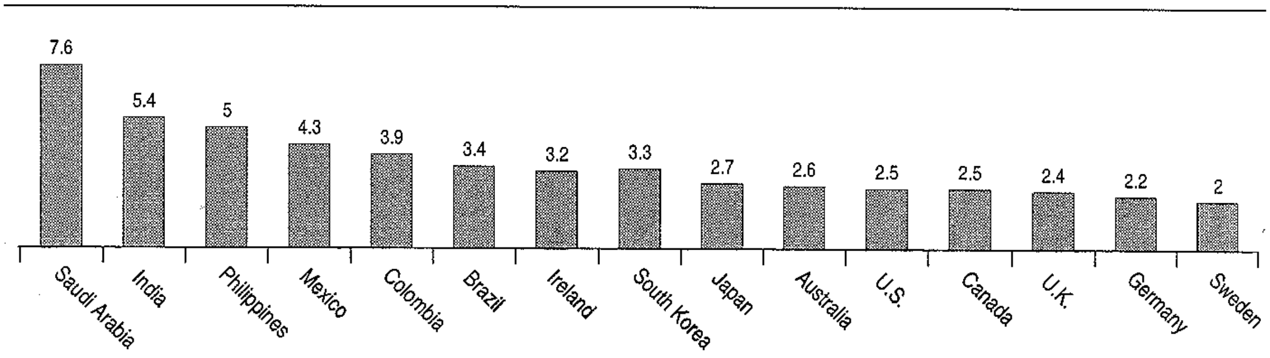
Another shortfall of homeownership rates as indicators of the quality of a country's housing finance system is that they demonstrate very little about the quality of private owner-occupied housing. The breadth of definitions utilized by various countries to define households and homeownership implies that the quality and infrastructure of housing can vary significantly around the world.

This discrepancy appears to be most acute between developed and developing countries. According to the U.S. Census 2000, more than 99% of homes in the U.S. have plumbing,[6] virtually all homes have some form of heating, and less than 6% of homes are classified as crowded, with more than one person per room.[7] The median lot size in the U.S. is 9,100 square feet or one-fifth of an acre,[8] and the average number of persons per room is 0.5. By contrast, in India the average middle-class family (two children, two parents, and two grandparents) resides in a 500-square-foot space,[9] which is the approximate size of many U.S. studio apartments. According to the United Nations, the average number of persons per room in Mexico is 1.4, which would qualify most Mexican homes as "crowded" by American standards.[10] If Mexico's household density were adjusted to reflect U.S. density averages, Mexico's homeownership rate would be less than 30%, rather than 84%. Both the robustness of housing infrastructure and household density have an impact on the quality of life experienced by the inhabitance of owner-occupied housing around the world.

Changes in homeownership rates may merely reflect population and demographic shifts rather than changes in the ability of a housing system to meet consumer needs. When a country's population is increasing at a rapid rate, because of an increase in immigration or birth rate, the total number of homeowners must grow at approximately the same rapid rate in order for its homeownership rate to remain constant. Thus, a stable homeownership rate in the face of rapid population growth does not indicate stagnation or deterioration of a housing finance system.

Take the case of the U.S., which received an influx of 9 million foreign-born immigrants in the past decade and where the current population growth rate is 0.90%,[11] which is relatively high for a developed country. The num-

Figure 2. Population per Dwelling



Source: "Pocket World in Figures." The Economist, 2003 ber of households in the U.S. increased by 11 million in the 1990s. To merely maintain its 1990 homeownership rate of 64%, the U.S. would have to increase the number of homeowners by 7 million by the end of the decade. In fact, the number of U.S. homeowners rose by 10 million and the U.S. homeownership rate rose to 67% in 2000.

Legal systems and laws of land tenure in various countries differ significantly. For example, the United States, Australia, Britain, and Canada have similar legal systems where the rules and regulations are consistent, and the rights and obligations of the public and of various government agencies are clearly defined. Owner occupation means substantially the same thing in each of these countries.[12] As a result, homebuyers understand the title and registration process and can anticipate the amount of time and money that will be required to purchase a home and obtain clear title to their property.

A sound title and registration infrastructure is a critical component of a country's legal system for housing finance, as it allows lenders to confidently extend secured loans. In the developing world, informal owner-occupied dwellings are sometimes included when reporting official homeownership rates. For example, in the city of Tegucigalpa, Honduras, the owner occupancy rate in 1998 was 79%. This high rate of owner occupancy can be attributed to the fact that 46% of all residential properties in Tegucigalpa were obtained through illegal land invasion, while another 13% have unclear or restricted titles. Only 40% of the residential properties in the city have proper legal titles and authorized construction.[13] The process of legally obtaining a home in Peru can take as long as six years and eleven months to complete and consists of five stages, with the first stage alone involving 207 steps.[14] As a result, it becomes too burdensome and expensive for property owners to go through the process of registering their property, which leads to informal land occupation.

A government's housing policy can also have a significant impact on homeownership rates. For example, in the U.S., Mexico, and the Netherlands mortgage interest payments are tax deductible, thus promoting homeownership through individual financial incentives. In the U.K., the number of owner occupiers increased by 28 percentage points between 1951 and 1981. A significant portion of this increase can be attributed to the sale, at below market rates, of rental housing by private landlords.[15] Private landlords sold these properties to tenants largely as result of laws protecting security of tenure for tenants and government-imposed rent restrictions that negatively impacted the value of these investment properties. The growth of owner-occupiers in the U.K. in the 1980s can largely be attributed to the sale of state-owned properties to tenants by local authorities and new towns through a government program championed by Margaret Thatcher, entitled the "Right to Buy." During Thatcher's tenure as Prime Minister, from May 1979 through November 1990, the homeownership rate in the U.K. rose from 54% to 65%.[16]

Furthermore, aggressive housing policies may increase homeownership significantly, yet the resultant rise in homeownership rates may not reflect an underlying improvement in the quality of the housing finance system.

South Africa is a case in point. Since coming to power in 1994, the African National Congress has promoted an aggressive subsidy policy that resulted in the construction of more than a million homes, which in most instances were given to underprivileged families. The direct result of this policy, in a country with 43 million people[17], is a much higher homeownership rate. This subsidy policy has no direct positive impact on South Africa's housing finance system.

Alternative Indicators of Housing Finance System Efficiency

A variety of factors external to the housing finance system affect the rate of homeownership. These factors include the definitions of home and homeownership, housing density, population growth rates, and the legal and regulatory environment. Thus homeownership rates alone are an incomplete measure of the quality of a country's housing finance system. Useful measures of housing finance system strength examine the affordability of housing, the ease of access to financing, predictable payment amounts, and the ability and flexibility to refinance in lower interest rate environments without bearing extensive prepayment penalties.

The lender's margin, or the difference between mortgage rates offered to consumers and the lender's cost of funds, is an indicator of affordability. In general, in environments where lenders operate under slim margins, the housing finance system is more efficient. Comparing lender margins among housing finance systems is more meaningful than comparing interest rates because the latter does not take inflation into account, and inflation can vary a great deal from country to country. The U.S., by comparison to other free market economies, operates under some of the slimmest margins. While lender costs of funds and mortgage rates fluctuate, a fixed 30-year mortgage rate in the U.S. is currently approximately 50 basis points greater than the cost of funds in the capital markets.[18] In Germany lending margins range between 30 and 80 basis points[19], while average mortgage margins for banks and building societies in Britain are about 150 basis points.[20]

One measure of the ease of access to funding is the loan-to-value ratio (LTV) offered to consumers. Loans with LTVs as high as 97% are readily available in the U.S., and organizations concerned with affordability may offer 100% LTV products. In the U.K. in the early 1990s, banks offered loans with 130% LTVs to help homeowners who were in a negative equity position sell their existing homes and purchase new ones. In contrast, in Germany LTV ratios are low and average between 40% and 60%.[21] Since first-time homebuyers in Germany require more time to amass substantial savings for downpayments the average first-time homeowner in Germany is older than those in many other countries where average LTVs are higher.

The availability of mechanisms that enable borrowers to mitigate interest-rate risk effectively is another critical indicator of the robust nature of housing finance systems. Few countries offer fixed-rate mortgages that enable borrowers to fix their mortgage payments at origination for periods of greater than 25 years. With a variable-rate mortgage, interest rate risk is borne by the individual homeowner rather than by the lending institution. Where interest rate fluctuations are severe, the interest rate risk facing the borrower with a variable-rate mortgage is formidable. For example, in South Africa between the beginning of March 1988 and the end of October 1989 mortgage rates increased by more than 8%.[22] In most countries around the world either the consumer or the government bears interest rate risk. Notable exceptions include Denmark and the United States, which offer 30-year, fixed-rate mortgages.

Finally, consumer-centric housing finance systems enable borrowers to refinance mortgage loans without significant prepayment penalties or administrative costs. This type of housing finance system provides borrowers the opportunity to reduce their housing costs by refinancing during falling mortgage rate environments. In some countries where fixed-rate mortgages are offered, prepayment penalties can be onerous. In Germany, for example, if a homeowner wishes to prepay their mortgages it is common practice for lenders to charge a yield maintenance fee in association with early redemption.[23] In France prepayment penalties are waived only if a property is sold as the result of the borrower losing a spouse, unemployment, or employment related relocation.[24] Denmark and the U.S., by contrast, are the only markets in the world where consumers can fix their mortgages at loan origination for the life of the loan and refinance or cancel the mortgage without any prepayment penalties.

Gauging the strength of a nation's housing finance system from homeownership rates alone can give a distorted and even deceptive picture of reality. Factors such as quality of housing, whether homes are crowded, whether units are occupied by the actual owners, and whether housing opportunities are keeping pace with growth in the number of households are not captured consistently, rendering international homeownership rate comparisons problematic.

NOTES

1 Ellen P. Roche, "Loans Around the World," *Secondary Mortgage Markets: A Freddie Mac Quarterly* 14 (1997).

2 Statistics Canada (http://www12.statcan.ca/english/census01/products/standard/popdwell/Tables.cfm), accessed November 12, 2002.

3 Census of India 1991. These units have walls and roofs made of permanent materials, such as burnt bricks, metal sheets, stone or cement concrete. "Temporary" materials include grass, leaves, reeds, bamboo, unburnt bricks and mud.

4 "Home Ownership, House Purchases and Mortgages: International Comparison." *Council for Mortgage Lenders,* August 2000.

5 U.S. Census Bureau (http://quickfacts.census.gov/qfd/meta/long_71063.htm) accessed November 12, 2002.

6 Plumbing includes hot and cold water, a bathtub or shower, and a flush toilet.

7 U.S. Census Bureau (http://factfinder.census.gov/bf/_lang=en_vt_name=DEC_2000_SF3_U_DP4_geo_id=01000US.html) accessed November 12, 2002.

8 Real Estate Intelligence Report (http://www.reintel.com/numbers.htm) accessed November 13, 2002.

9 Haya El Nasser, "U.S. Neighborhoods Grow More Crowded." *USA Today,* July 7, 2002.

10 United Nations (http://www.un.org/Depts/unsd/social/housing.htm.) accessed November 12, 2002.

11 CIA World Factbook (www.cia.gov/cia/publications/factbook/geos/us.html) accessed November 12, 2002.

12 "Home Ownership, House Purchases and Mortgages: International Comparisons." *Council of Mortgage Lenders,* August 2000.

13 Dr. Shlomo Angel, *Housing Policy in Honduras: Diagnosis and Guidelines for Action.* June 2002, pp. 6-7.

14 Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else,* New York: Basic Books, 2000, pp. 19.

15 "Home Ownership, House Purchases and Mortgages: International Comparisons." *Council of Mortgage Lenders,* August 2000.

16 Find a Property.com (http://www.findaproperty.co.uk/cgi-bin/story.pl?storyid=0853) 3 November 2000.

[17] "Pocket World in Figures." *The Economist,* 2003, pp. 14.

[18] *The Wall Street Journal,* November 10, 2002.

[19] "Pfandbrief Issuers Business Overhaul," *Euromoney,* April 2001.

[20] According to The Irish Bankers Association, in "Mortgages: The Facts," *Sunday Business Post,* June 30, 2002.

[21] "Hypostat." European Mortgage *Federation,* 2000, pp. 49.

[22] Reserve Bank of South Africa.

[23] Achim Duebel and Michael Lea, "Micro- and Macroeconomic Consequences of Residential Mrotgage Prepayment: A Legal and Economic Analysis," Verband Deutscher Hypothekenbanken, Bonn and Verlag Fritz Knapp GmbH, Frankfurt, 2000.

[24] *International Housing Finance Sourcebook,* 2000, pp. 176–181.