Summary

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Low deposit dwellings
- a trap for home buyers?
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The reasons for the study

For a sustained period, Bank of Norway raised its key interest rate. Financial institutions followed suit and put up mortgage rates. The media got hold of stories about people's problems with debt and a slow market for low deposit dwellings in housing cooperatives. The media were curious about marketing practices in connection with these developments; the sort of information prospective buyers were given; purchasers' ability to penetrate the hype and work out what the house was likely to cost everything included; likely housing expenses under different mortgage rate scenarios; and what private credit institutions had done to gauge the mortgagor's solvency before releasing a down payment loan.

The problems arose because some of the dwellings in the housing cooperatives were being sold with high levels of joint debt and low deposits. Jointly held loans or debts often provide an instalment free period for the housing cooperative. Those who bought low deposit dwellings when interest rates were low, faced a sharp increase in outlays joint costs and other expenses associated with repaying the deposit loan as the interest rate grew.

The Minister of Local Government and Regional Development set up an inquiry in June 2008 to investigate the situation and devised a plan of action. One of the resulting measures involved asking the State Housing Bank to investigate the prevalence of problems related to low deposit dwellings. This is that report.

The Housing Bank were interested to ascertain what the dwellings were sold for, how they are financed, how joint debts are repaid, whether housing cooperatives are insured against default on joint costs, who sold the dwellings and whether the real estate agencies adhered to their code of practice.

They were also interested in whether low deposit dwellings are expensive, whether the marketing material presents them as less expensive than they are, whether promotions targeted the young segment of the market at a time of low interest rates and, therefore, low joint costs.

Another important issue concerned the incidence of default on joint costs in housing cooperatives, whether defaulting is likely to increase or subside over the next three years, and what sort of prices are obtained in the market for existing dwellings.

According to our findings, the recent upswing in interest rates created payment problems for some residents, but they are not concentrated in the low deposit housing segment. While problems are not necessarily caused by the low deposit model, before we can reliably identify those causes, the practices of financial institutions vis-à-vis home buyers, particularly of low deposit dwellings, should be investigated.

Some general remarks on low deposit dwellings

The current The Housing Cooperatives Act was passed on June 6 2003, and entered into force on August 15 in 2005. In addition to housing associations, the Act permits other developers, including organizations and public undertakings, to own some or all of the shares of a housing cooperative. Previously, stakeholders other than the housing associations were obliged in law to set up the cooperative as a joint venture, that is, prospective share-holders in the cooperative had to convene and draw up a foundation document. In the new law there are no constraints on who could create a cooperative or how long the shares should remain in their hands. The amendments to the law provided an incentive for developers to adhere to the housing cooperative model.

One of the features of buying a dwelling in a housing cooperative is the lower risk, compared with owner-occupied dwellings because a major part of the credit is in the form of a jointly held loan. If the sale price of the unit falls below the value of the jointly

held load, the resident may terminate his right of residence with six months' notice, after which he will no longer have responsibility for the jointly held loan. But he will have lost his deposit. The low deposit housing cooperative therefore reduces the risk of loss for *the individual member* but the risk to *the housing cooperative as an entity* grows.

In other words, residents of housing cooperatives are jointly responsible for the jointly held loan. NBBL (Norwegian Federation of Co-operative Housing Associations) have a loan insurance scheme that insures against the risk of default on joint cost payments. Membership of the scheme requires deposits to be at least 20 per cent in housing cooperatives affiliated to a housing association, and 25 per cent for independent housing cooperatives. Further to this, an overall assessment is made of the financial structure and price per square metre. The cost of membership of the guarantee fund is 0.35 per cent of the budgeted joint costs. 3590 housing cooperatives of some 7,000 have signed up to the fund. Some housing associations have their own guarantee schemes.

If the sale price per unit on a cooperative estate falls below the jointly held loan, the unit will not be transferable on the market. This applies equally to foreclosure sales. The housing cooperative must repossess the unit, increasing the jointly held loan costs for the remaining members of the society. The housing cooperative may decide to let the unit in anticipation of a better economic climate when it can be sold. The rent they can charge may be lower than the cost of paying the jointly held loan and managing the estate, adding additional strain to members' expenses. Going into administration is one strategy if a large number of members terminate their right of residence when the units are effectively unsellable.

Registering sale prospectuses on housing cooperative units

Eiendomsverdi AS runs a database of sale prospectuses and prices in new housing projects. It covers year 2004 to the present. NIBR has taken this as its point of departure and registered prospectuses put on the market between July 1 2006 and end of September 2008. Arntsen et al. (2006) used the database and registered low deposit unit prospectuses from 2004 to July 1 2006. NIBR was given access to this database.

Housing cooperatives must fulfil the following criteria before registering with NIBR's database. The criteria were set up beforehand by the study's commissioner.

- All new housing cooperative projects with an average deposit share lower than 25 per cent
- Projects with at least one unit with a deposit share equal to 20 per cent or less
- Projects with "high prices"
- Projects with only single-room and two-room units
- Projects aimed at the young segment of the market
- Projects with an instalment free period on the jointly held loan longer than ten years
- Projects with a more than 30-years' term on the jointly held loan

According to Eiendomsverdi's database, about 630 housing cooperatives advertised units on the market between July 2006 and September 2008. Prospectuses which lacked information on prices, floor space, payment terms on the jointly held loan or information on marketing directed at young adults were not registered in NIBR's register.

Some of the projects were erroneously registered as housing cooperatives, some had been taken off the market, some were counted more than once because they were entered anew at every stage of the construction as a unique housing cooperative, and others failed to provide sufficient information enabling us to determine whether they were low deposit housing cooperatives or not.

NIBR registered 183 housing cooperatives on the basis of the criteria noted above. These low deposit housing cooperatives comprised 43 per cent of all housing cooperatives on which we had sufficient information to determine whether they were low deposit housing cooperatives or not. It is important to remember here that the terms and constitutions on the jointly held loan were a criterion for inclusion in the low deposit unit category in this connection.

A survey about payment problems

As a point of departure for selecting housing cooperatives for a survey on defaults on jointly held loans, we had two databases of registered housing cooperatives, that held by NBBL on low deposit housing cooperatives and NIBR's own register. The two populations provided basis for the selection process. We selected 150 housing cooperatives for further investigation. Only housing cooperatives with deposit of less than 25 per cent were considered. We selected as the same number of housing cooperatives from each population. The gross sample were cut to 106 due to overlaps between housing cooperatives in the two databases and because the housing cooperatives were either not established or had been cancelled. We received responses from 91 housing cooperatives that we could use in the analysis.

The original idea was to call the chairman of the board of each housing cooperative for answers to questions posed in the questionnaire. After a time, however, we decided that the business manager would probably know more about current payment problems, the issue we were most concerned to investigate. Some of prospectuses failed to indentify the business manager, so we used information on the housing cooperatives at the Brønnøysund Register Centre to locate these business managers. Business managers, it turned out, were highly knowledgeable and more than ready to answer our questions in considerable detail.

Default on payment of jointly held loans

Many of the housing cooperatives built in the first part of the study period are beginning to make payments on their jointly held loan following an instalment-free five years. Anticipated drop in interest rates in 2009 and the assumptions informing estimates of the interest rate movements in the foreseeable future will, however, reduce housing costs for most of them. If problems do arise in connection with repaying loans in low deposit dwellings or other residential arrangements, it will not be due to housing costs per se. The price of low deposit units from 2004–2006 grew so much, prices would have to plummet before the jointly held loan exceeded the sale price.

The survey of business managers of a selected group of low deposit housing cooperatives, 2004–2006, shows that 105 of 2,424

residents or 4 per cent have found it difficult to pay, and have defaulted on jointly held loan repayments. Prevalence of these problems is not tied to construction year, but is slightly higher in housing cooperatives with the lowest deposits.

Sale prices and mortgage interest rates were lowest in the first part of the period, and many home buyers have since experienced a sharp, and unexpected, rise in joint costs, especially on housing estates with a privately financed joint debt. Buyers at the end of the period had to pay more for the dwelling, but the higher mortgage rate at the time meant that housing costs would not rise to unanticipated heights than buyers should have been prepared for.

Is the prevalence of payment problems higher among members of low deposit housing cooperatives than other housing schemes? It is not easy to say. In 2003, 5.4 per cent of people granted a start-up loans in 2000 in Oslo were in arrears by 60 days or more. A review of some randomly selected proceedings opened in 2008 at Drammen City Court to consider applications for a foreclosure sale found in 75 per cent of the cases that he residential units in question were on housing developments built before 1990. Two of ten cases concerned units on estates built 2004–2006. Not many foreclosure petitions lead to actual eviction or a foreclosure sale. In brief then, while the rise in interest rates in recent years did cause repayment problems for some, they were not overly concentrated in the low deposit housing cooperative segment. Our findings also remove any suspicion that the low deposit housing model in itself might be to blame for the problems. Before we give a fuller answer as to the causes of payment problems, one should, however, take a closer look at finance institutions' credit practices in connection with the purchase of dwellings, particularly low deposit dwellings.

Deposit percentage and identifying developers

A survey of new dwellings constructed in 2005 found that the deposit paid by 9 per cent of the residents of new housing cooperative dwellings was below the 20 per cent mark, while 77 per cent paid 25 per cent or more (Barlindhaug & Ekne Ruud 2008). Our study of the prospectuses and the business manager survey both indicate declining numbers of housing cooperatives offering deposits at less than 20 per cent since 2005.

Private developers built 70 per cent of housing cooperative properties registered at NIBR as low deposit dwellings on the basis of the criteria listed above. The housing associations accounted for 20 per cent, while the remaining projects were joint ventures between housing associations and private developers. The housing associations were responsible for half of the projects where deposits were set at less than 20 per cent.

Resident mix and guarantee schemes

Roughly every third low deposit dwelling on a cooperative estate are occupied by young adults, while 40 per cent of housing cooperatives have occupants across all age groups. The lower the deposit, the younger the household.

About half of low deposit housing cooperatives are affiliates of a housing association, with the likelihood of such affiliation growing with diminishing deposits. According to the surveyed business managers, eight out of ten low deposit housing cooperatives are insured against joint cost-incurred losses. Affiliated housing cooperatives are insured more often than the independent housing cooperatives.

Sales process, estate agency practice and the projects' "young image"

Good estate agency practice is defined under the 2007 amendment to the Estate Agency Act. Many of the projects were on the market before the amended law came into effect from January 1, 2008. According to the testimony of the business managers, good estate agency practice was observed by six out of every ten housing cooperatives, though our investigation found that to be the case in only 14 per cent under prevailing law. Only 6 per cent of the projects target the young adult segment of the market, in our estimation, increasing to 13 per cent for projects with deposits lower than 20 per cent.

Financing and economy

Many of the prospectuses lack adequate information identifying the originator of the joint debt. When the housing cooperative is established and financing arranged, funding of the joint debt in 44 per cent of the projects is by the State Housing Bank, say the business managers. Of housing cooperatives with deposits below

20 per cent, the State Housing Bank finances the joint debt of 6 out of 10 housing cooperatives.

Our review of the prospectuses found only three of the registered housing cooperatives offering a joint debt at a fixed rate. But more than 119 of the 183 projects failed to specify whether the rate was fixed or adjustable. Most housing cooperatives operating with deposit levels below 25 per cent had an instalment free period of less than ten years and a 20–30 year repayment term. Of the housing cooperatives with deposits above 25 per cent, but which had not been registered, 38 per cent had a 50-year repayment term on the joint debt. About half of the prospectuses say that the housing cooperative has or will provide an individual repayment scheme (IN-ordning), i.e., the possibility to repay part the joint debt individually because borrowing needs are less than the joint debt.

The State Housing Bank financed low deposit housing cooperatives

The State Housing Bank financed a greater percentage of low deposit housing cooperative projects built in the early part of the period 2005–2008 when prices were lower than at the end of the period and there was less focus on guarantee or security schemes. Since the proportion of low deposit units with deposits below 20 per cent was higher early in the period, the State Housing Bank financed more of these housing cooperatives than private banks, according to our survey of business managers. The geographical location of the development varied little according to whether it was financed by the State Housing Bank or by private finance institutions. There appears to be a lower proportion of young people and a relatively higher proportion of mixed age groups in housing cooperatives financed by the State Housing Bank. Residential units in the latter were also more likely to be sold by the developer than an estate agency, and developers were also more likely to adhere to the code of practice.

Sale prices of new and existing housing

A comparative study of sale prices obtained for projects registered with NBBL in 2005 and sale prices obtained for new housing constructed in 2005, registered in Barlindhaug & Ekne Ruud

(2008), was unable to say conclusively that the sale price of low deposit dwellings in 2005 was higher than that of similar housing.

On the basis of sale prices of low deposit housing registered with both NBBL and NIBR, we provide information on sale price movements during 2005–2007. Sale price movements are compared with Statistics Norway's construction price index for multi-dwelling housing and sale prices for existing cooperative dwellings in the same period. The result of this comparison does not allow us to say that the sale prices of low deposit dwellings constructed in 2006 and 2007 were higher than other comparable housing.

Data obtained from finn.no were used to estimate the effect of joint debt on total prices obtained in the market for existing housing cooperative dwellings in 2003 and 2008. Both years showed that house prices rose when joint debt per square metre floor space rose. We cannot say on the basis of these data that low deposit housing obtains lower prices in the market for existing dwellings compared with similar dwellings.

After reviewing the project costs, revenue from sales and contribution margins of four expensive projects, developments in central areas are expensive, but attain a higher sale price in this segment of the market. Rising interest rates, financial collapse and speculators unable to whether the storm in a sinking market have undermined normal profit margins and two of the projects should expect a negative contribution margin.

On the low deposit dwelling model

There appears to be a general pull-back from the low deposit housing segment, partly due to stories in the media, but also because of developers' experience with the model.

Although defaulting on joint costs is not concentrated in housing cooperatives with high levels of joint debt, prices fetched in the marked are no higher than for similar dwellings. The low deposit model is nevertheless under some stress.

The new Estate Agency Act together with a branch norm and reports on improving guarantee schemes for housing cooperatives could mitigate some of the adverse press given low deposit housing cooperatives. In addition, steps should be taken to

examine financial institutions' practice as regards loans given for deposits; at high joint debts in need of repayment; and at the situation that arises when a buyer has no need to borrow from a financial institution to buy a low deposit dwelling. Where, in this latter situation, does the onus lie to advice against the purchase?

Developers are calling for action in connection with housing market speculators, and banks, guarantee funds and developers are conscious of the dangers of having a system of differentiated deposits in the same housing cooperative project.