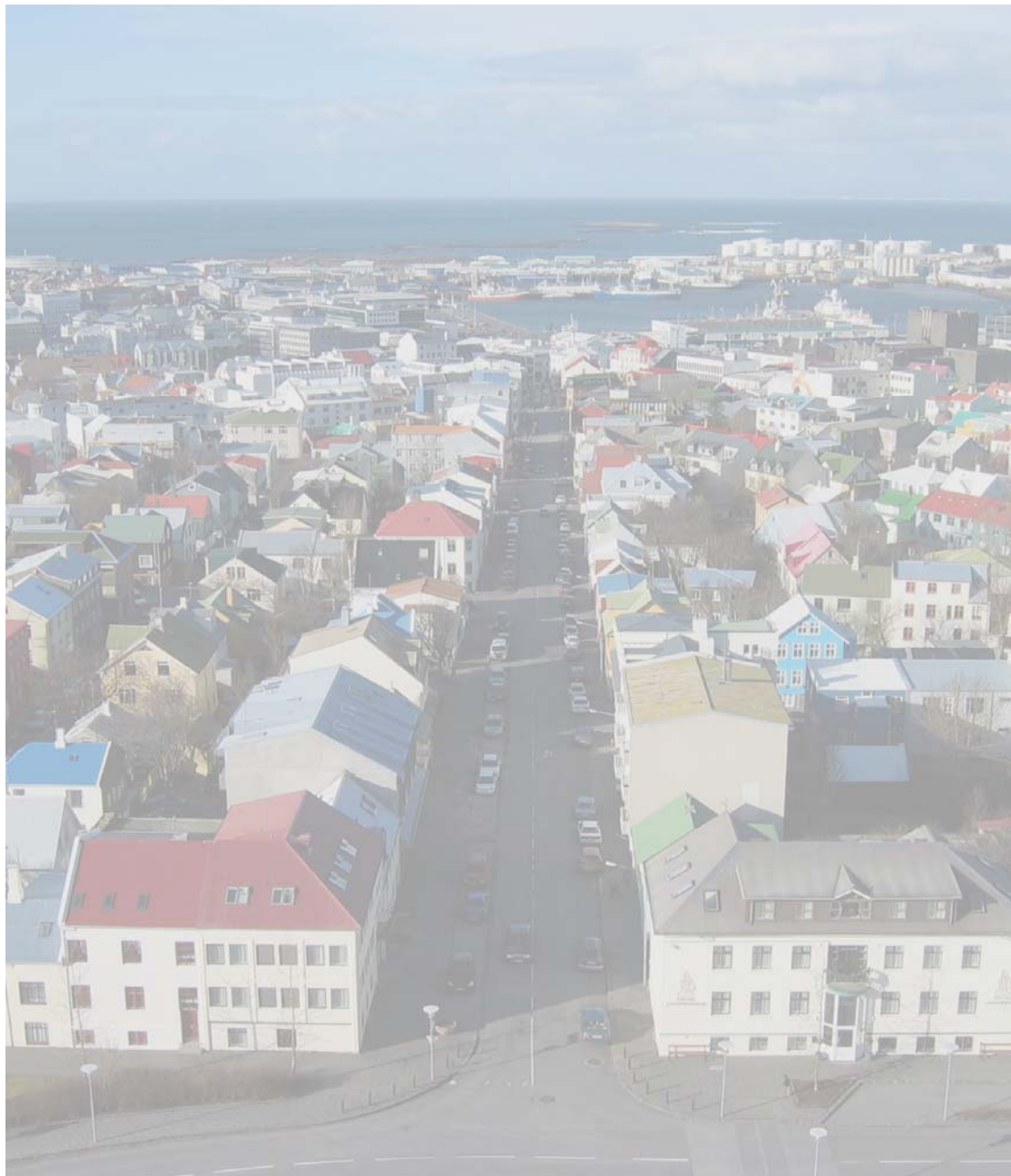


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# Mortgage Credit Markets in Iceland and Other European Countries

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## Summary

- This report is based on a survey carried out by the Consumers' Association of Iceland during the spring and summer of 2005. Information was collected on various aspects of mortgage credit markets in ten European countries.
- In some respects, the markets are similar. Thus, mortgage loans are normally issued for 30 to 40 years. Amounts are primarily determined on the basis of property market values. Loans most often amount to 80-100% of market value. Customer loyalty and credit history frequently influence credit terms. Some flexibility is common when credit terms are being negotiated.
- Great differences exist between charges paid by borrowers to governments and financial institutions. Stamp duties and other related taxes range from being nonexistent up to 9% of property value. Borrowing charges vary from zero to 3%. Special charges for making payments also vary greatly.
- Nominal interest rates on mortgage loans are generally low, at 3-5%. The difference in interest rates between countries, however, is from 2% to almost 10%.
- Considerable differences appear in real interest rates, from 0.2% to 6.9%.
- Maximum maturity is generally longer in the Nordic countries, at 30 to 60 years, than in other European countries. Loan-to-value ratio is lower in the Nordic countries, at 60-90%, than in the other countries examined. Governments in four out of five Nordic countries levy stamp duties of 1.5 to 3.5%.
- Borrowing costs in the Icelandic mortgage market are a great deal higher than is the norm in the nine other countries. Direct borrowing charges are higher, the cost of making instalment payments is much higher, and prepaying in full is generally more costly.
- Interest rates are higher in the Icelandic market than in any of the countries in the survey. Nominal rates are 2 to 7 percentage points higher than in other Nordic countries. Real interest rates are generally 2 to almost 5 percentage points higher than elsewhere in Europe.

# Table of content:

- 1. Introduction.....5
- 2. Profiles of markets in ten European countries.....6
  - Austria .....6
  - Denmark .....7
  - Finland.....8
  - Germany.....9
  - Iceland .....10
  - Ireland.....11
  - The Netherlands .....12
  - Norway .....13
  - Sweden.....14
  - UK.....15
- 3. Qualitative and quantitative comparison.....16
  - The length of maturity.....18
  - Loan-to-value (LTV).....18
  - Assessment of value .....18
  - Difference in maximum LTV due to regional differences .....18
  - Further conditions .....18
  - Stamp duty and other taxes.....19
  - Fees and borrowing cost .....19
  - The interest rate .....19
  - Collection charge pr. instalment .....20
  - Prepayment charge .....20
  - Indexation .....20
- 4. Comparison of the Nordic countries .....21
- 5. The real interest rate .....23
  - Fixed interest rate loans .....23
  - Variable rate loans.....24
- 6. Conclusion.....26
- Appendix I.....28
- Appendix II.....30

# Table of figures:

- Table I ..... 6
- Table II ..... 7
- Table III ..... 8
- Table IV ..... 9
- Table V ..... 10
- Table VI ..... 11
- Table VII ..... 12
- Table VIII ..... 13
- Table IX ..... 14
- Table X ..... 15
- Table XI ..... 16
- Table XII ..... 17
- Table XIII ..... 25

## Introduction

The mortgage credit market constitutes an important subsector of the financial markets in most modern economies. That is especially true in Iceland, where private ownership of housing is the norm and rental housing is limited. The Icelandic sector has become more vibrant in recent months, during which banks have made concerted effort to recruit customers and lure them away from the traditionally dominant public Housing Financing Fund.

The Consumer Association of Iceland has concerned itself with the development of financial services market in Iceland, in particular the mortgage credit market. The Association has commissioned studies of the market and taken part in discussions on policy questions regarding financial regulations. The Association has also tracked and documented important market changes. A special emphasis has regularly been placed on putting these changes in the context of developments in other European economies. The present study has been conducted in the same tradition.

In order to assess the market for mortgage credit, data from ten European countries has been collected<sup>1</sup>. All are parties to the European Economic Area. All except two, Norway and Iceland are full members of the European Union. Questionnaires were sent to representatives of consumer associations in all these countries. The questions covered various market aspects, such as loan maturity, term conditions, stamp duties, borrowing charges, interest rates and indexing. The complete list of questions appears in an appendix.

Returned replies to these questions were collected by the office of the Icelandic Consumer Association. Two members of the association's governing board, Jonas Gudmundsson M.A. and Olafur Klemensson MBA, have analysed the collected data and prepared this report.

The Minister of Social Affairs has supported the Consumer Association in carrying out research work on the housing market and this support has been used to make this study possible.

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<sup>1</sup> Questionnaires were sent to a total of 13 countries in spring of 2005. First draft of this report was reviewed by additional information provided in July 2005.

## Profiles of markets in ten European countries

The following are that basic data provided for each of the countries: Austria, Denmark, Finland, Germany, Iceland, Ireland, the Netherlands, Sweden and the United Kingdom.

Table I

<b>Austria</b>	<b>The country profile - main characteristics</b>
Loan maturity	Usually 25 years with variable interest rate but 5-10 years for fixed interest rate loans. The most common maturity is 3-5 years
Maximum loan	Loan-to-value can be as high as 70-80% of market valuation
Assessment of value	Market valuation
Do loans vary to different regions	Usually not, with exception of loans, financially supported by public funds
Further conditions	Client history will influence conditions
Stamp tax and duties	No stamp duty but land register duty
Fees and borrowing Cost	1-3%
Fees and borrowing cost on refinancing loans	1-3%.
Interest rate Variable Fixed	3.5-5.3% 4.5-5.5%
Collection charge pr. instalment	€14-30 each year
Prepayment charge	Usually not applied
Indexation	From 1999 banks are obliged to peg interest rates up and down in accordance to a reference rate the bank has defined in the contract. Usually the reference rate is the policy rate of the Austrian Central Bank, the Euribor rate or the bank's average interest rate

**Table II**

<b>Denmark</b>	<b>The country profile - main characteristics</b>
Loan maturity	30 years for all accepted clients
LTV	80%
LTV based on	Market value
Assessment of value	Market value
Do loans vary to different regions	No
Further conditions	Credit worthiness
Stamp tax and duties	1,5% stamp duty + € 190. The stamp duty can be transferred to new mortgage loans for a fee of € 170
Fees and borrowing Cost	€ 120+ fee for selling the bonds, also levied on refinancing loans
Fees and borrowing cost on refinancing loans	€ 120+ fee for selling the bonds, also levied on refinancing loans
Interest rate Variable Fixed	2-2,5% 5-5,5% (market based)
Collection charge pr. instalment	The building societies levy an annual fee based on outstanding debt
Prepayment charge	€ 120 + fee for selling the bonds (the borrower buys the underlying bonds and swaps them with the building society)
Indexation	No

**Table III**

<b>Finland</b>	<b>The country profile - main characteristics</b>
Loan maturity	Generally 20-25 years, some banks have 30 years maturity and up to 60 years as a limit
LTV	Normally 70% but certain mortgage banks have a maximum of 60%.
Assessment of value	Market value
Do loans vary to different regions	LTV can be adjusted according to the liquidity in the local housing market
Further conditions	No, but customer loyalty and client history can affect the interest margin
Stamp tax and duties	Stamp duty was abolished in 1998
Fees and borrowing Cost	€ 0-100
Fees and borrowing cost on refinancing loans	€ 0-100
Interest rate Variable Fixed	2.8-3.1% n.a.
Collection charge pr. instalment	n.a.
Prepayment charge	No
Indexation	No, but 95% of all loans are pegged to a reference rate, in most cases an average rate published by the banks or the Euribor-rate

**Table IV**

<b>Germany</b>	<b>The country profile - main characteristics</b>
Loan maturity	Undefined period for loans with variable interest rate 20+ years for fixed interest loans, most customers choose long maturity with fixed rate as the present level of interest is low
LTV	Normally 80% but in some cases up to 110% (high creditworthiness)
Assessment of value	Market value
Do loans vary to different regions	Possibly, lower loans in economically weaker regions (Länder)
Further conditions	Loyalty of customer, degree of creditworthiness
Stamp tax and duties	0,5% mortgage fee
Fees and borrowing Cost	Generally no fee or borrowing cost but few banks may charge up to 0,5% of the loan value
Fees and borrowing cost on refinancing loans	Same as above
Interest rate Variable Fixed	3,18-4,8% nominal rate but 3,34-4,91 effective rate (Feb. 2005) Maturity 5 years: 3,28-4,17% Maturity 10 years: 3,68-4,62% Maturity 15 years: 3,92-4,95%
Collection charge pr. instalment	Nil.
Prepayment charge	Depends on the loan contract, if the customer has the right of termination then there is no charge, otherwise the customer has to pay prepayment indemnity charge
Indexation	There has been discussion about indexation of loans

**Table V**

<b>Iceland</b>	<b>The country profile - main characteristics</b>
Loan maturity	40 years in general, same with fixed interest rate and variable rate loans but the length of the loan is according to the customers wishes. Nearly all mortgage housing loans are fixed interest rate loans
LTV	Usually 80-90% but up to 100% is possible but up to the max. €300.000. One bank mentions that max. loan depends on the customer's ability to pay back and the LTV ratio.
Assessment of value	Market value but in some cases fire insurance value can also be applied
Do loans vary to different regions	In all banks but one, the same max. of loan is applied in all regions but the largest bank is setting the maximum to 60% in rural areas or where the bank does not have a branch
Further conditions	Two of three commercial banks set conditions for client history, customer loyalty or having an account at the bank; the savings banks and the State Housing Financing Fund do not establish such conditions.
Stamp duty	Stamp duty on new mortgages is 1,5%, on refinancing loans it is 0,75% of the value of the issued loan
Fees and borrowing Cost	1% of loan value
Fees and borrowing cost on refinancing loans	1-2% of loan value. Only one bank charges 2%, but can be negotiated lower.
Interest rate Variable  Fixed	4.9-6.9% real interest rate=7.8% nominal rate and up to 9.8% (y/y inflation May 2005) Mortgages in foreign currency basket →3.22-5.62% variable interest rate Non-indexed loans →10.05-13.45% variable interest rate 4.15-5.25% real interest rate=7.1-8.2% nominal rate Most common are fixed rate loans at 7.1% (on indexed loans) or 4.15% real rate
Collection charge pr. instalment	€ 1,8-6,0 each payment
Prepayment charge	0-2% but generally 2% of the rest value in three of the five financial institutions taking part in the survey
Indexation	Nearly all mortgage loans in Iceland are with inflation indexation clause

**Table VI**

<b>Ireland</b>		<b>The country profile- main characteristics</b>	
Loan maturity	Loans with variable interest rate up to 35 years Fixed interest loans up to 10 years Decision on maturity is made by customers ability to repay-usually at customers discretion		
LTV	Up to 100% for high income customers 97% for affordable housing mortgages co-sponsored by local government For other lenders, on average 92%		
LTV based on	Income/profession of persons applying for loans		
Do loans vary to different regions	No		
Further conditions	No-but ability to repay is crucial		
Stamp tax and duties	First time buyers are exempted from paying stamp duty up to the value of €317,500 3% stamp duty on value between € 317,500-381,000 6% " " € 381,000-635,000 9% " over € 635,000		
Fees and borrowing Cost	Nil		
Fees and borrowing cost on refinancing loans	Nil		
Interest rate Variable Fixed	Lowest rate 3.1% but the most common rate is 3.4-3.6% APR 5.32%		
Collection charge pr. instalment	Not available		
Prepayment charge	Only on fixed interest rate loans, as most lenders charge an average of six months interest payment		
Indexation	No		

**Table VII**

<b>The Netherlands</b>	<b>The country profile - main characteristics</b>
Loan maturity	In general 30 years, both fixed and variable interest rate loans due to the fact interest expenses are tax-deductible for a maximum of 30 years but maximum maturity up to 40 years is possible
LTV	Mostly 125-130% of realisation value (executiewaarde) which mean that the loan-to-value is 106-110% of market value in general but can be as high as 127%
Assessment of value	Realisation value for older houses, but cost of building for new houses
Do loans vary to different regions	No
Further conditions	Loyalty of customer is helpful
Stamp tax and duties	Special tax of 6% on the price of existing houses but VAT of 19% on new houses
Fees and borrowing Cost	Most lenders charge 1% commission on new loan contracts
Fees and borrowing cost on refinancing loans	If new loan is defined as a continuing loan contract, no fee is charged but if the customer wants to have a lower interest-rate loan, he has to pay a fee of € 125-225
Interest rate Variable Fixed	2,6-4,1% 5 years maturity →3,45-4,6% 10 years maturity →4,0-5,3% 30 years maturity→4,8+5,5%
Collection charge pr. instalment	Such costs are included in the interest rate
Prepayment charge	Only on fixed interest rate loans, the charge is based on the discounted interest loss
Indexation	No

**Table VIII**

<b>Norway</b>	<b>The country profile - main characteristics</b>
Loan maturity	Maximum of 30 years but most common 15-25 years for loans with variable interest rate 90% of mortgages are variable interest rate loans Fixed interest rate loans are usually with 1-10 years maturity, but 82% of fixed rate loans are within 1-5 years
LTV	Normally 60-80% but in some cases 80-100% (full financing loans and loans to first-time buyers) in relation to the customer's creditworthiness, anticipated future ability to meet payments and additional guarantees In 2004, three-fourth of all issued loans are within 80% LTV
Assessment of value	Market value
Do loans vary to different regions	Some financial institutions are less willing to issue loans between 80-100% LTV in regions with less turnover/sale
Further conditions	No default can be a condition, many financial institutions have loyalty programmes and may set better terms such as lower interest rate
Stamp tax and duties	Stamp duty of 2.5% and registration fee is € 260
Fees and borrowing Cost	€ 0-300
Fees and borrowing cost on refinancing loans	Not common practice to charge fees on refinancing loans
Interest rate Variable Fixed	2,94-3,84% (effective rate) n.a.
Collection charge pr. instalment	Up to € 4,2 pr. each instalment
Prepayment charge	Nil if it is a variable interest rate loan, but if the loan is a fixed interest, then the customer has to pay a discount fee according to the market rate of interest
Indexation	No

**Table IX**

<b>Sweden</b>	<b>The country profile - main characteristics</b>
Loan maturity	The max. maturity can be 60 years, both for fixed interest rate and variable interest rate loans
LTV	Normally 75% but in some cases 95%
Assessment of value	Market valuation
Do loans vary to different regions	Some financial institutions are not offering housing loans in all parts of Sweden
Further conditions	The client must have a salary account at the bank
Stamp tax and duties	1-2%
Fees and borrowing Cost	€ 60-120
Fees and borrowing cost on refinancing loans	€ 60-120
Interest rate Variable Fixed	2,99% 1 year→ 3% 2 years→ 3,25% 5 years → 4,0% 10 years→ 4,85% 12 years→ 5,3%
Collection charge pr. instalment	Mostly nil.
Early payment charge	Nil. on variable interest rate loan but on loans with fixed interest rate, then the customer has to pay a discount fee according to the difference in interest rates between the outstanding loan and a new loan
Indexation	No

Table X

<b>UK</b>	
<b>The country profile - main characteristics</b>	
Loan maturity	25-30 years for Standard Variable Rate (SVR) loans 5 years for discounted variable rate loans 10 years max. for fixed interest rate loans In 2001, 40% of loans were SVR, 26% were fixed, 8% capped and 17% capped variable Around 90% of new mortgage lending is either variable or fixed for no more than 10 years
LTV	1/2 of mortgages in the 0-75% LTV category 30% " 76-90% " 16% " 91-100% " 5% " > 100% "
Assessment of value	Mainly market value
Do loans vary to different regions	Yes, according to regional disparities in both income and property values
Further conditions	Yes, better rates for loyal customers, household income is critical and virtually all lenders have policies about minimum income multiples for advances (loans). In 2003 2/3 of first time buyers had the income multiples of 2,0-4,0
Stamp tax and duties	< € 90,000 → 0% € 180,000-375,000 → 1% € 375,000-750,000 → 3% € 750,000 → 4%
Fees and borrowing Cost	Some lenders charge € 450-900, others roll fees and borrowing costs into the total price of the loan
Fees and borrowing cost on refinancing loans	n.a.
Interest rate	The lowest rate is 4.5% and the highest is 7,3% on fixed interest rate loans , on variable rate loans it is 3.5-6,79% Standard rates: National Building Society Standard Rate: 6,15 or 5,99% SVR Capped rates: Marsen BS: 6,3% APR (Average percentage rate) or 5,39% nominal rate to 2010 then 6,79% SVR Skipton Building Society: 5,3% APR or 4,43% nominal rate fixed to 2012, then SVR at 6,09% Lambeth Building Society: 7,3% APR fixed for 4 years then 6,11 SVR
Collection charge pr. instalment	n.a.
Early payment charge	nil
Indexation	No

## Qualitative and quantitative comparison

The main findings of the survey on terms and conditions have been compiled in the table below.

**Table XI**

	Iceland	Denmark	Norway	Sweden	Finland
Maximum loan maturity—fixed interest	40 years	30 years	10 years	60 years	N/a
Maximum loan maturity—variable interest	40 years	30 years	30 years	60 years	20-25 years (but up to 60 years can be seen)
Term determinants	Individually negotiable	All accepted clients have the same loan maturity	Individually negotiable	Banks' discretion	Individually negotiable
Loan-to-value	80-90%	80%	60-80% (max. can be 100% in some cases)	75% but in some cases up to 95%	60-70%
Assessment of value	Market value	Market value	Market value	Market value	Market value
Do loans vary to different regions	No	No	In some cases	In some cases	In some cases
Further conditions for loan approval	Client history and debt servicing capacity	Credit worthiness	Client history in some cases	Client must have a salary account at bank	Client history can affect interest margin
Stamp tax and duties	1,5%	1,5%+€ 190	2,5%+registration fee of €260	1-2%	No
Stamp tax and duties for refinancing	0,75%	€ 170	Reg. fee of €260 if changing bank	No	No
Fees and borrowing cost	1% of loan value	€ 120+fee for selling the mortgage bonds	€0-300	€ 60-120	€0-100
Fees and borrowing cost on refinancing	1-2% of loan value	€ 120+fee for selling the mortgage bonds	Not common practice	€ 60-120	€0-100
Interest rate range—fixed rates	7,1-8,2%	5-5 ½ %	n.a.	3-5,3%	n.a.
Interest rate range—variable rates	7,8-9,8%	2-2 ½ %	2,94-3,84% (eff. rate)	2,99%	2,8-3,1%
Collection charge pr. instalment	€1,8-6,0	Annual fee	Up to € 4,2 pr. Instalment	At most banks no charge	n.a.
Prepayment charges	0-2% on fixed interest rate loans	€ 120+fee for selling the mortgage bonds	Nil on variable interest rate loans, prepayment charge on fixed interest rate loans	Nil on variable interest rate loans, on fixed interest rate loans is a prepayment charge	No
Indexing	Yes, on nearly all mortgage loans	No	No	No	No

**Table XII**

	<b>Germany</b>	<b>Netherlands</b>	<b>Ireland</b>	<b>Great Britain</b>	<b>Austria</b>
Maximum loan maturity—fixed interest	20 yrs	30-40 yrs	10 yrs	10 yrs	5-10 yrs
Maximum loan maturity—variable interest	Undefined	30-40 yrs	35 yrs	5-30 yrs	25 yrs
Term determinants	Individual preferences	Tax advantages	Customer's discretion	Customer's income	
Max. loan-to-value	80-110%	106-110%	92-100%	Up to 100%	70-80%
Loan amount determined by	Market valuation	Realisation value on older houses, cost of building on new houses	Income/ profession of applicant	Market valuation	Market valuation
Loan decisions influenced by geographical location	Yes, possibly	No	No	Yes	Not regularly
Further conditions for loan approval	Client history	No; some connection to client history	Ability to pay	Household income, customer loyalty	Client history
Stamp tax and duties	0,5%	No but 6% tax on older houses and 19% VAT on new houses	Yes, 3-9%. First-time buyers exempted up to house value of € 320 thousand	Yes, 0-4%	Land register duty
Stamp tax and duties for refinancing	0,5%	No	No	Yes, € 120	N/a
Fees and borrowing cost	0-0,5%	1%	No	Some banks charge between € 450 - 900	1-3%
Fees and borrowing cost for refinancing	0-0,5%	0- € 225	No	N/a	1-3%
Interest rate range—fixed rates	3,28-4,95%	3,45-5,5%	5,3%	4,4-7,3%	4,5-5,5%
Interest rate range—variable rates	3,18-4,91%	2,6-4,1%	Lowest 3,1%	3,5-6,79%	3,5-4,5%
Collection charges pr. Instalment	0	0	Not available	Not applicable	€ 14-30
Charges for premature payment in full	Yes, unless negotiated	Only on fixed interest rate loans	Only on fixed interest rate loans	0	Usually not
Inflation indexing	No	No	No	No	No

The information above has been analysed quantitatively as well as qualitatively as the answers from the participating consumers organisations permit us to. The terms which has been analysed are the maximum of maturity of mortgage, loan-to-value (LTV), how the assessment of value is made, whether loans vary between regions, whether further conditions are applied, fees and borrowing costs, stamp duty, interest rates, collections charge and prepayment charge and lastly if inflation indexation is used.

## **The length of maturity**

The highest maximum maturity of mortgages with fixed and flexible interest rate is 60 years in Sweden and Finland<sup>2</sup>. The most common maturity is 20-30 years but the average length is 22 years for fixed interest rate loans and 31 years for flexible interest. In general, the maximum maturity is the longest in the Nordic countries or 38 years on average for fixed interest rate loans and 42 years for variable interest rate loans. The maximum maturity of fixed interest rate loans in the other European countries in this survey is 18 years for fixed rate loans and 29 years on variable interest rate mortgages.

## **Loan-to-value (LTV)**

The highest LTV ratio or 110% of market value can be found in the Netherlands and the lowest LTV can be seen in Norway or 60% of market value<sup>3</sup>. The most frequent LTV ratio is 70-75% of market value and the average LTV in all the 10 countries in the panel is 77%. There is not a big divergence in the maximum LTV between the countries, as all countries but three, (The Netherlands (110%), Germany (110%) and Finland (70%)) are offering a maximum LTV of 80-100%.

## **Assessment of value**

All but two countries are calculating their LTV ratio on market value of properties. Only The Netherlands and Ireland are calculating the maximum LTV on other criteria. In Ireland the LTV ratio is based on the income and profession of the person applying for a loan and in The Netherlands the valuation is build on the realisation value of houses.

## **Difference in maximum LTV due to regional differences**

Out of the 10 countries in the panel, in five countries a differentiation in the LTV according to regions can be seen. The most common way to differentiate is to set lower ratio of LTV in regions where the housing market is less blooming, in economically deprived regions or where the average salary is lower than at the national level.

## **Further conditions**

In nine cases, further conditions are set for loan approvals, in the form of customer loyalty or client history such as no-default, creditworthiness or having a salary account at the lenders bank.

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<sup>2</sup> In general, the maturity in Finland seems to be 20-25 years, although some banks are offering 30 as a limit and up to 60 years

<sup>3</sup> The most common LTV in Norway is between 60-80% of market value

## **Stamp duty and other taxes**

Stamp duties are applied in seven countries but on a wide scale. In two countries, The Netherlands and Austria, other forms of duties are applied (land register duty and a tax on purchase of housing properties). The lowest stamp duty applied is 0.5% of the property value (in Germany) but can be as high as 9% in Ireland on properties worth more than €635,000. In five countries a flat stamp duty is applied but in the UK and Ireland the stamp duty is progressive according to the value of the property. The most frequent stamp duty, where applied is between 1-2%.

## **Fees and borrowing cost**

Fees and borrowing cost are charged in nine countries, in different forms and magnitude. In five of these nine countries, fees and borrowing cost is always charged but in four countries it seems to be different between banks and/or between customers if borrowing cost is charged. In four of these countries, which charge borrowing cost and/or fees, the cost is a flat percentage of the value of issued loan and in five countries the borrowing cost is a fixed amount, from as low as € 60 and up to nearly € 900. In Iceland, Austria and The Netherlands the general practice is to charge a borrowing cost on all new loans in the magnitude of 1-3% but in Germany 0-0.5%.

## **The interest rate**

The single most important part of the loan terms for the ordinary customer is the interest rate. In comparison, the range of interest rates between the 10 countries of this survey are quite disperse, from as low as 2-2 ½ % to as high as 9,8%. In all cases, Iceland has the highest interest rate but the other four Nordic countries with The Netherlands and Ireland, the lowest. There are several reasons why the interest rate is so high in Iceland. The mortgage market is extremely small with only 300,000 inhabitants and the general interest rate and interest margins tend to be higher in smaller markets and in smaller currency areas. All long term loans in Iceland are inflation indexed and the inflation in Iceland is now and has been in the past much higher than in the other nine countries in this survey. The average rate of inflation in the nine countries other than Iceland in this panel, is 1.75% (year on year increase in CPI in April 2005) but was 2,9% in Iceland (CPI May 2005). This explains much of the interest rate difference between Iceland and the nine countries. And finally, the repo-rate of the Central Bank of Iceland was at 9.5% (summer 2005) which is three to four times higher than in the other European countries.

The most frequent rate of interest is in the range of 4.5-5.5%, the high average is 5.9% and the low average is 4.9% across the 10 countries. The lowest interest rate is to found in

Denmark at 2-2 ½ % on variable interest rate mortgage loans and the highest at 9,8% is in Iceland on a non-indexed variable rate loans<sup>4</sup>. This means that the rate of interest in Iceland on mortgage loans can be up to four times higher than the lowest to be found in these 10 countries.

### **Collection charge pr. instalment**

In six countries, collection charge is either unknown or not common, but in four countries a collection charge is either levied on each instalment or paid on an annual basis. The collection charge is highest in Norway and Iceland, in Norway up to € 4.2 pr. instalment and in Iceland up to € 6.0 pr. instalment.

### **Prepayment charge**

In six countries, some kind of prepayment charge can be found and then only on fixed interest rate loans. In Iceland, three banks out of five are charging a flat 2% as prepayment indemnity; the other two are not charging such a fee. In Ireland, the usual prepayment charge is six months interest payment. In four countries, The Netherlands, Germany, Norway and Sweden, the prepayment indemnity is calculated according to the remaining time of the loan, the interest rate in the loan contract and the actual rate of interest at the time of the prepayment.

### **Indexation**

In Finland, Austria and Iceland certain forms of indexation can be found. There is though a fundamental difference how the indexation is applied and calculated. In Finland and Austria, the interest rate must be adjusted according to an index defined in the loan contract. This can be e.g. the Eurobor-rate or any other daily noted rate. In Iceland on the other hand, the indexation of loan contracts is calculated as an inflation adjustment of the principal of the outstanding loan. The nominal interest rate is therefore calculated as the sum of real interest rate fixed in the loan contract and monthly rate of inflation.

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<sup>4</sup> Non-indexed long term loans in Icelandic currency are not common in Iceland

## **Comparison of the Nordic countries**

In general, the terms and conditions seem to be rather similar in the Nordic countries, as would be expected. If any, Icelandic banks stand out when it comes to the total costs of housing mortgages. The maximum period for fixed interest rate loans in Norway stands out as the lowest, 10 years. The maximum period for variable interest rate loans is on average between 30-40 years. Some Finnish and Swedish banks are though advertising loans up to 60 years.

Term determinants seem to be according to the client's discretion or individually negotiable. The LTV is on average 70-80% of market value. In three countries, Norway, Sweden and Finland maximum loans can differ between regions according to the market situation.

Client history and creditworthiness of the clients evidently play some role when terms and conditions are set.

Fiscal stamp duty and/or registration fee is levied in four countries, only Finland is exempt as stamp duty was abolished in 1998. Stamp duty in the four Nordic countries is between 0,75-3.5%.

In five instances out of 12, the Icelandic banks stand out in the Nordic comparison.

1. This is in the loan charge on new loans and refinancing loans which can be up to 2%, but generally 1%. This is much higher than in the other Nordic countries where this fee is between € 0-300.
2. The nominal interest rate is much higher in Iceland<sup>5</sup> than in the other four Nordic countries. On loans with variable interest rates the Icelandic banks are charging to 5,8-7,8 percentage points higher interest rate than the lowest banks in Denmark. When it comes to fixed interest rate, the interest rate charged by the Icelandic banks are 4 percentage points higher than in Sweden and 2,1 percentage points higher than in Denmark.

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<sup>5</sup> In the case of Iceland the nominal interest rate is calculated as the real interest rate+changes in the consumer price index over the last 12 months period.

3. The cost of paying instalments is also, in general, much higher in Iceland than in other Nordic countries, although an exact comparison can in be difficult in some cases.
4. In Iceland, three out of four commercial banks levy an early repayment charge of 2% on fixed rate loans. Only the Housing Financing Fund (HFF), which is owned by the government and Reykjavik Savings Bank do not charge such a fee for early repayment<sup>6</sup>. In other Nordic countries, the early repayment charge is either nil or calculated on the basis on possible interest loss (the discounted difference between the current interest rate and the fixed interest rate on the loan).
5. Inflation indexation is the common practice in Iceland due to the long history of high inflation. Therefore, indexation is nearly on all mortgages in Iceland as well as most medium term consumer credit loans.

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<sup>6</sup> This was according to the actual situation in the spring 2005

## **The real interest rate**

Although the nominal interest rate is assumed to be the most important single factor when it comes to negotiating terms and conditions of a mortgage loan, it is the real interest rate which economically and financially plays a much bigger role. Besides that, the inflation rate is significantly different between the countries in this survey and the actual or expected inflation rate is one of the main determinants of the interest rate. It is therefore imperative to calculate the real interest rate across the countries in this panel in order to compare the real rate in a cross sectional manner and also to compare the real rate of fixed rate loans to variable rate loans in each country. In this study, real rate is calculated as the nominal rate less the year on year increase in the consumer price index (the rate of inflation last 12 months April '04-april '05).

The real rate is calculated separately for the fixed rate loans and the variable rate loans as there is an indicative difference in most countries between the fixed and variable rate loans.

### **Fixed interest rate loans**

The average real rate across the panel of these 10 countries on low interest rate loans is 2.3% (2.0% if Iceland is excluded) and 3.7% on the high interest rate loans (3.2% Iceland excluded). The lowest real rate is to be found in the UK and Ireland, 1.2% and 1.3% respectively but the highest real rate is in Iceland at 5.25% (see TableXIII). It is exactly in this context why it is so important to assess the interest rate in real terms as can be seen in the case of the UK with the second highest nominal rate after Iceland but when adjusted for the inflation, the real rate turns out to be less than average. When looking at the lowest rates in each country, the UK turns out to be at the panel's average at 4.4% nominal rate but in real term with the lowest rate of 1.2%. The highest real rate is in Iceland<sup>7</sup>, or appr. 2-3.5 times higher than the lowest real rates (in the UK, Ireland and Germany). The real rate in Iceland is 2.2 percentage points higher than the average real rate in the nine other countries. There is, however, a somewhat smaller difference between the highest real rates across the countries. The real rate is highest in Iceland but only marginally higher than in Sweden. The highest real rate in Iceland is 1.6 percentage points higher than the average real rate of the other countries.

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<sup>7</sup> Large majority of all mortgages in Iceland are fixed interest rate loans or 90-95%

## **Variable rate loans**

The average real rate across the ten countries on low interest rate loans is 1.8% (1.5% Iceland excluded) but 2.8% on high interest rate loans. The average spread between the lowest and the highest rates is only 1 percent points compared to 1.6 percent points for the fixed rate loans. Across the spectrum the interest rate is the lowest in Denmark, both the nominal rate and the real rate. The lower real rate is only 0.2% and the higher real rate is 0.7% in Denmark. This comes to some surprise as the real rate in Denmark of fixed interest rate loan is the sixth highest out of eight countries (see TableXIII). The same applies for the structure of interest rates in the UK. The lowest real fixed interest rate is found in the UK but when it comes to the variable rate, the UK is the highest, when Iceland is excluded<sup>8</sup>. In The Netherlands the real fixed rate is among the highest but the real variable rate among the lowest. Only Germany, Ireland and Sweden seem to keep a balance between real rates of fixed and variable rate loans. This could indicate a distinctive structural difference between the housing loan markets or the mortgage markets in these countries. The second and third lowest are Austria, Ireland and The Netherlands. The low average of real rates across the panel is 1.8% and the high average is 2.8%. As in the case of fixed rate loans, Iceland is again the champion with the highest real rates, lowest 4.9% and the highest 6.9%. This is 2.5-2.6 times higher than the average across the 10 countries or 3.2 times higher than the other nine countries' average. This indicates that the real rates on variable rate loans in Iceland are considerable higher in a relative perspective than the real rate on fixed interest loans.

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<sup>8</sup> It can be assumed that Iceland is an outlier in this comparison as the nominal and the real rates are so much higher than in the other nine countries

**Table XIII**

In % p.a.	CPI *	Fixed interest rate loans				Variable interest rate loans			
		Low average	High average	Low average	High average	Low average	High average	Low average	High average
		nominal rate	nominal rate	Real rate	Real rate	nominal rate	nominal rate	Real rate	Real rate
Austria	2.6	4.5	5.5	1.9	2.9	3.5	5.3	0.9	2.6
UK	3.2	4.4	6.9	1.2	3.8	6.0	6.8	2.8	3.6
Germany	1.6	3.3	5.0	1.7	2.4	3.2	4.8	1.6	3.2
The Netherlands	1.5	3.5	5.5	1.9	4.0	2.6	4.1	1.1	2.6
Ireland	2.2	3.5	5.3	1.3	3.1	3.1	3.6	0.9	1.4
Denmark	1.9	5.0	5.5	3.2	3.7	2.0	2.5	0.2	0.7
Norway	1.3	.. **	..	..	..	2.9	3.8	1.6	2.5
Sweden	0.3	3.0	5.3	2.7	5.0	3.0	3.0	2.7	2.7
Finland	1.2	..	..	..	..	2.8	3.1	1.6	1.9
Iceland ***	2.9	7.1	8.2	4.2	5.3	7.8	9.8	4.9	6.9
Average	1.9	4.3	5.9	2.3	3.9	3.7	4.7	1.8	2.8
Average excl. Iceland	1.8	3.9	5.6	2.0	3.7	3.2	4.1	1.5	2.3

- CPI=Consumer price index, changes in the last 12 months April '04/April '05, except Iceland May '05
- \*\* Information not available or not applicable
- \*\*\* Calculated nominal interest rate=real interest rate+inflation last 12 months (May '05)

## **Conclusion**

The above analysis shows considerable diversity among the sampled countries with regard to specific characteristics of the European mortgage markets. Local market conditions and local governmental policies seem to prevail and lead to variations in many aspects of the markets. This does not apply to all aspects, however. Some are strikingly similar. These include:

- Loan amount is primarily determined by value of the property concerned. Income and profession of applicant are an important determinant in one country (Ireland)
- In most of the countries the LTV offered is in the range of 80-100%. In one country (Finland) it does not go beyond 70% but in two it exceeds 100%.
- In most of the countries, maximum loan maturity is between 30 and 40 years. In some cases, maximum maturity is only 10 years and in others it is up to 60 years. On average, somewhat shorter maturity applies to fixed interest rates loans than loans with variable rates.

The greatest differences appear in the following factors:

- Tax and stamp duties (levied by the government) appear to be charged on a wide scale, from 0 to 9% of property. The most common rates are between 1 and 2%.
- Fees and borrowing costs (collected by financial institutions) also vary considerably among the countries, from 0 to 3%. In some cases they are fixed lump sums, from € 60 to € 900.
- Nominal interest rates vary widely from 2% to 9.8%. The most common rates are between 4 and 5%. In general, variable interest rates are lower than fixed interest rates.
- Real interest rates range from 0.2% to 6.9%. The difference between low and high real rates appears to be somewhat greater on variable rate loans than on fixed rate loans. Nonetheless, the real rates are, on average, lower on variable rate loans than on fixed rate loans.
- Although indexing seems to be uncommon in Europe, one case of complete indexing to the cost of living is found and there are others of pegging interest rates to reference rates.

The Nordic group of countries display more uniform conditions than the other countries in the survey.

- Loan maturity is generally longer in the Nordic countries, at 30-60 years, than in the rest of the sample. Norway's 10-year maturity of fixed rate loans is an exception.
- LTV is 60-90% in the Nordic countries. Other European countries may offer 100% and above.
- Four out of five Nordic countries levy stamp duties, at 1.5-3.5%. Finland is an exception with no stamp duty.

Iceland stands considerably apart when it comes to factors affecting cost of borrowing for the consumer:

- Its fees and borrowing costs of 1% or 2% are much higher than in the other Nordic countries. Only Austria shows similar or higher borrowing costs in the sample.
- Nominal interest rates are much higher in Iceland, differing by 2 to 7 percentage points from the other Nordic countries.
- Real interest rates are also much higher in Iceland than in the other Nordic countries – in fact higher than in any of the sample. A much wider range is found in real interest rates on variable loans than on fixed interest loans.
- The cost of paying instalments is, in general, much higher in Iceland than in other Nordic countries.
- Most commercial banks levy a prepayment charge of 2% on both fixed and floating interest rate loans. In other Nordic countries, the prepayment charge is either zero or calculated on the basis of possible interest loss.

The above conclusions bring out, in specific terms, important similarities and differences between mortgage credit markets in a number of European countries. Although they all are parties to the European internal market, great differences apparently exist. The Icelandic mortgage credit market shows particular differences that should be of interest to consumer associations and authorities in the country.

## **Appendix I.**

### *The questionnaire used in the survey.*

1. What is the longest period for which the loans are issued, as applying to:
  - a. Loans with fixed interest rates
  - b. Loans with floating interest rates
  - c. That which determines the loan period for individual customers.
  
2. What is the maximum amount of a loan in relation to the value of the property being purchased?
  
3. What is the maximum based on?
  - a. Market valuation
  - b. Fire insurance valuation
  - c. Other. What?
  
4. Do maximum loans vary according to different regions in the country and if so, why?
  
5. Do lenders set conditions for providing housing financing loans, such as customer loyalty or client history?
  
6. Must the debtor pay stamp duty to the authorities when taking new housing financing loans, and if so, how high is this percentage?
  
7. Does the debtor have to pay stamp duty to the authorities when taking new housing financing loans to be used for refinancing older housing financing loans and if so, how high is this percentage? Please provide examples from banks and companies/funds in the public sector.
  
8. Do lenders levy a loan charge on new housing financing loans and if so, how high is this percentage? Please provide examples from banks and companies/funds in the public sector.

9. Do financial institutions levy a loan charge on new housing financing loans that are used for refinancing older housing financing loans and if so, how high is this percentage?
10. How high are interest rates on housing financing loans: floating interest rates on the one hand, and fixed interest rates on the other?
- The lowest interest rates?
  - The highest interest rates?
  - The most common interest rates?
11. What is the cost to the consumer for the payment of each instalment (excluding the instalment itself and the interest rates)? Please provide examples from banks and companies/funds in the public sector.
12. Does a charge apply if a customer wishes to pay off a loan in full? Please provide examples from banks and companies/funds in the public sector.
- The lowest charge
  - The highest charge
  - The most common charge
13. Has there been any discussion in your country on taking up indexing of loans?

## Appendix II

### *Government Mortgage Market Intervention: An International Perspective*

**Denmark:** Mortgage credit is provided by specific private mortgage credit institutes, which date back to the 18<sup>th</sup>. Century. Mortgage credit is provided on competitive conditions, financed through the issuance of mortgage bonds. There are no subsidies of mortgage interest rates. Homeowners can deduct their mortgage interest expenses, like any other interest expenditures from their pre-tax income.

**Finland:** The main task of *ARA*, the State Housing Fund of Finland, is to provide state subsidized rental housing production—about half of all rental dwellings in Finland are subsidized by the state. There are no general interest subsidies for private homeownership (which is mainly promoted through tax relief on mortgage interest payments, in line with the practice in most Western economies); however, interest subsidies can be granted based on social needs.

**Norway:** *Husbanken*, the State Housing Bank, mainly lends for new housing, but also plays a role in providing social support targeted at low-income households, seniors, and individuals with disabilities. In 2002, 0.4% of GDP was allocated to grants and benefits, and 0.9 % was allocated to new lending. The Housing Bank has participated in the financing of approximately 50% of existing homes in Norway. Given its focus on social lending, at end 2002 Husbanken only accounted for 14% of outstanding mortgages.

**Sweden:** The publicly owned *SBAB* was founded in 1984 to channel state housing loans; however, today there are no more interest rate subsidies for single-family homes, and *SBAB* competes on equal terms with the private mortgage institutions, accounting for 11% of the Swedish mortgage market. Currently, interest rate subsidies are only available for multi-family houses, rental and condominiums, with the subsidy amount meant to correspond to the tax relief on mortgage interest payments available for homeowners.

**France:** There is public assistance through the mortgage system, mainly through a dedicated savings scheme—*plan d'épargne-logement*—which has been used for the purchase of 40% of owner-occupied housing. There are also regulations on private sector mortgages, and there is a regulated loan scheme—*prêt conventionné*—for public sector institutions and lenders. Zero-interest mortgages are offered to low-income households.

Although the exact scope of France's public involvement in the mortgage market is difficult to assess, it seems well below that in Iceland, in particular considering a homeownership rate of only 55%.

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Sources: CBI (2004*b*); [www.ara.fi](http://www.ara.fi); [www.boverket.se](http://www.boverket.se); [www.husbanken.no](http://www.husbanken.no); [www.realkreditraadet.dk](http://www.realkreditraadet.dk); and [www.sbab.se](http://www.sbab.se)