Box 1 Main changes in the housing market in 2004

Major changes have taken place in the Icelandic mortgage market this year. The state Housing Financing Fund (HFF) has expanded its activities and the commercial banks have captured a share of the market.

The HFF's maximum loan amounts were raised in the beginning of the year and again in October. In total they were increased from 8 m.kr. for housing in the secondary market and 9 m.kr. for new housing to 11.5 m.kr. for either category. The combined ceiling for main and second mortgages has also been reset at 13 m.kr.

The format of HFF bonds was changed in July. Loans are now disbursed to borrowers in cash, instead of the old tradable housing bonds. Interest rates are fixed but reflect market yields at the time the mortgage bonds are issued. They are in an annuity format with a maturity of 10, 20, 30 or 40 years and two due dates per year. Interest rates on mortgage loans had come down to 4.15% at the end of November, compared with 5.1% on the housing bonds that they replaced.

At the end of August, the commercial banks responded to the changes in HFF terms by offering CPI-indexed mortgages at a lower rate of interest (4.3%) and a loan-to-value ratio of up to 80% (relative to market prices) or 100% (of fire insurance value), whichever was lower. As a rule these loans are indexed with a maturity of 25 or 40 years, and carry a fixed rate of interest (in some cases with five-year review clauses), which had come down to 4.15% at the end of November. Since these loans are not confined to housing purchases, they can also be taken for refinancing and mortgage equity withdrawal. Some savings banks and pension funds have responded to this competition by lowering their interest rates and raising their loan-to-value ratio.

The HFF's increase in its maximum loan amounts in October was made earlier than planned, and its loan-to-fire insurance value ratio was increased from 85% to 100%. In turn, the banks began offering 100% loans, although these are subject to various restrictions and differ in a number of ways from the 80% loans on offer. For example, their maximum amount is set at 25 m.kr., while 80% loans are unlimited. Another requirement is that they are only used to finance housing purchases, and the borrower's debt service capacity is put through a more stringent evaluation process. From August 23 to the end of October the banks had disbursed mortgage loans amounting to more than 50 b.kr. A large proportion of the new borrowing has been used to prepay older loans from the HFF, whose market share has contracted recently.