

Housing and Options

At

**Reverse Mortgage Seminar – “How to Use Your Home to Stay
At Home”**



by

Dr. Marion Williams

Governor

Central Bank of Barbados

Grande Salle

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Good morning Mr. Chairman, members of the Board, deputy governors and members of management, Mr. Jeff Taylor – our guest facilitator for today’s session, ladies and gentlemen.

Introduction

Two years ago we started a series of seminars on “Increasing the Range of Financial Instruments in Barbados”. The first in the series was on mortgages and during that seminar, there was a great deal of interest generated about reverse mortgages. We therefore promised ourselves that, at an appropriate time, we would hold a seminar specifically on reverse mortgages. This is essentially what this seminar is about - trying to provide a wider range of options within the marketplace from which consumers and investors can benefit – and our topic today is reverse mortgages. I am pleased to say that we have been able to source a very able speaker today, Mr Jeff Taylor, who has a wide experience in this field. I would like to take the opportunity of thanking Warwick Ward for sourcing the speaker and for organising this seminar.

This seminar is really aimed at banking and finance technicians in the field but I believe we have some members of the public as well, and this is important, since it is they who will influence whether or not there is a demand for the facility. I believe we will be dealing with the general and more easily understood areas first which laymen can understand. As the day progresses it may become a little more complex.

Reverse mortgages are generally useful to elderly persons who have demands for cash and not sufficient access to it, while at the same time having considerable equity tied up in sometimes very expensive homes.

An Efficient Housing Finance Market

The real estate market, previously thought to be dealing in illiquid, non-tradable products, has become global in nature and can become liquid. Well-to-do foreigners today have choices in buying property in many parts of the world. In fact in some international cities, the apartment market is so liquid that you can buy an apartment in the morning and sell it in the afternoon. Housing markets are no longer solely domestic in nature, but are influenced by global trends. Housing prices, in an open economy are

therefore – to some extent – subject to international market discipline. A main concern however, is liquidity.

The financing of housing plays a major role in the growth of the entire financial system. While sometimes it grows faster than the economy can finance in terms of foreign exchange, it has an important social dimension. Housing represents an important, if not the most important form of household real savings. It must be noted however, that excessive investment in housing can lead to asset bubbles, and bursting bubbles can have implications for output, employment and inflation and for asset values. One should always therefore leave some room for the possibility of increasing interest rates, or for economic downturn, in order to pre-empt possible default.

It is also important to build efficient and robust housing finance systems if we are to intermeditate the relatively strong rate of domestic savings toward more effective investment.

Rigidities and inefficiencies in the market need therefore to be addressed as the sound development of primary and secondary mortgage markets is

important to the development of healthy bond and derivatives markets. As our population becomes more financially savvy, we will need to build a deep debt market, so that long-term investments in housing are matched by long-term savings.

About an estimated 30% of household monthly expenditure is spent on housing, which incidentally represent most of households' wealth and also most of its debt. Indeed, and most of us here could probably attest, a mortgage is the largest component of household debt. Too cheaply priced housing distorts the efficient allocation of scarce resources, while excessively expensive housing contributes to inflation and erodes economic competitiveness in the long run. We need to aim for balance and flexibility. A flexible housing market helps increase the mobility of workers and widespread home ownership offers, not only wealth distribution, but is a fundamental objective of any market economy with social responsibility, even though, at the macro level, as I constantly repeat, we need to strike the right balance between foreign exchange-earning activities and foreign exchange-using activities like housing.

Rising Demographic Pressures

The demand for housing arising from a growing population and greater urbanisation has put greater pressure on traditional housing finance structures. Even traditional credit unions, and government programmes are becoming more involved in providing long-term housing finance and in almost all markets, mortgage-related assets have a high and rising share of total financial assets. Consequently, the origination, servicing and holding of residential mortgages has become a major income source for banking systems around the world. However, at the current rate of housing expansion, a question of risk management and protection arises, not only for the lender but for the borrower.

The demographics of household savings are that one consumes before one reaches working age. On the other hand, when we retire, we may wish to dissave by drawing down our savings or our equity saved in our houses. This new form of financial service that is rapidly emerging as the world population ages – the reverse mortgage – allows the retired house-owner to live off the dissavings on his mortgage. Globally, more and more innovative financial institutions are beginning to provide this type of financial instrument. In other words, efficiency in the financial system through the

provision of options helps households manage their risks better. These risks are legal risk, interest rate risk, credit risk, liquidity risk, and operational risk.

In the entire process of housing delivery, it is essential to balance the interests of many parties. Therefore, the rights and obligations of each participant must be clearly defined and protected for the market to work efficiently. Households want good quality houses delivered on time. Lenders want to ensure that the finance provided will be recovered, and both lenders and borrowers want support service providers to provide legal, and other services which ensure that their various rights are protected. We at the Central Bank, through our bank supervisors will want to ensure that banks are following appropriate lending criteria, so that banks do not suffer losses to the detriment of the depositors, and that borrowers are given a fair deal.

For the housing finance market to mature, we need liquid secondary mortgage markets and the associated derivative markets. Secondary mortgage markets provide a channel for the banks to offload their mortgages as and when needed. Furthermore, the securitisation of mortgage helps develop the capital market, by matching long-term savings to meet the

demand for long-term home financing. The Central Bank of Barbados and indeed the Government have recognised this and are moving towards the facilitation of secondary mortgage instruments, probably by next year.

Global experience suggests that access to housing finance has been much more important than subsidised finance. If the housing prices are too high, it is extremely inefficient to compensate for this by subsidising interest rates. Such a move would not only distort housing supply, but also worsen efficient allocation of housing finance. On the other hand, housing affordability can in fact be improved by carefully designing the structure of the mortgage.

Mismatch in maturity between long-term mortgages and short-term deposits pose liquidity risks to the banking sector – which can be managed through the secondary market. Efforts by the Central Bank on developing a secondary mortgage market, will allow for long-term savings to be efficiently allocated to the financing of long-term investments, and thus help manage maturity mismatches. This will be an important step in ensuring an integrated and balanced approach to housing finance and financial markets.

The efficient economy of the 21st century is a flexible economy, whereby we create growth through productivity increases in both the tradable and non-tradable sectors. Similarly, in the financial system, we need to strike a balance between the development of equity, banking, bond and derivative markets. If managed well, with sound fundamentals, good fiscal discipline, monetary and price stability and robust financial infrastructure, the economy will maintain stable growth and the flexibility to cope with the greater volatilities of the global economy.

In essence, what will contribute to this is a number of financing options. This is the overarching theme of many of the Central Bank-sponsored seminars in this series. This seminar is yet another in the series aimed at developing and widening the range of financial instruments. As I mentioned, it is aimed principally at the banking and financial sector who will evaluate the risks and the benefits and determine whether they are positioned to offer these facilities. However, it is the consumers who can signal to the banks whether the demand is there. Do not conclude from this seminar that the Central Bank is recommending to consumers that they use reverse mortgages. That is a decision which only the individual can take, preferably after proper counselling by a financial adviser. We are educating the public

as to what is possible. In the end, it is up to the financial institutions to deliver and to the public to request the facility. Whether there will be a need for a specific regulatory framework and a role for the Bank as regulator or for Government, will be determined in response to the demand, to market indicators, and to continuing assessment of the issues. However, knowledge and information are the first steps in the process. We hope that we are able to bring that to you today.

Thank you for your attention.