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Bachelor Thesis

Home loans

- A study of banks' lending to finance housing -

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Glossary

assessed value	taxeringsvärde
blocks of flats	hyreshus
cogent	tvingande, bindande
contract law	avtalslagen
consumables	förburkningsvaror
conveyance	överlåtelse
dividend	utdelning
down payment	handpenning
enforcement service	Kronofogdemyndigheten
entry into the land register	lagfart
first mortgage loan	bottenlån
housing/home loan	bostadslån
housing market	bostadsmarknad
minimum capital requirement	kapitaltäckningsgrad
mortgage credit institution	bolåneinstitut
mortgage deed	pantbrev i fastighet
order a UC report	ta en UC
purchase price	köpeskilling
record of non-payment of debt	betalningsanmärkning
retirement savings	pensionssparande
running costs	driftkostnader
second mortgage loan	topplån
securities brokerage company	värdepappersbolag
Swedish Bankers' Association	Svenska Bankföreningen
Swedish Consumer Agency	Konsumentverket
Swedish Financial Supervisory Authority	Finansinspektionen
tenant-owned apartment	bostadsrätt
tenant-owner's association	bostadsrättsförening
valuation	värdering
valuer	värderingsman

Institutions

Swedish Financial Supervisory Authority, SFSA

SFSA is a public authority who, commissioned by the Government and the Parliament, supervises the companies acting on the Swedish financial market. The financial sector is regulated by both European and national law, still, the SFSA publishes supplementary regulations of which some are cogent, such as for example the SFSA's Code of statutes¹, whereas others serve as more general guidelines.(www.fi.se,1) The role of the organisation is to promote a financial system that is effective, stable and protects the consumer(www.fi.se,2). SFSA's main tasks are to issue permissions, draw up regulation and exercise supervision (www.fi.se,3). It also analyses trends and publishes statistics regarding the financial market.

Upplysningscentralen, UC

UC is the largest business and credit information agency operating in Sweden. The company's major owners are Swedbank, Svenska Handelsbanken, Nordea and SEB. UC deliver around 7 million basic data for decision-making in credit and commercial matters each year. UC keeps information about almost everything concerning a person's or a company's solvency, and it collects its information from several institutions, such as for example the National Tax Board. (www.uc.se,1) According to UC's site on the Internet, the consumer report contains the following information: the name, address and Swedish personal number, latest two years income, marriage settlement, property owner details, balance of debt with the enforcement service, payment complaints, claims etc as well as the most recent inquiries at UC. (www.uc.se,2)

The Swedish Consumer Agency

The Swedish Consumer Agency is a state agency, who provides for the protection of consumer interests. The agency works with various consumer related questions, such as advertising, consumer information, contract terms, household economy etc. (www.konsumentverket.se,1) Another main task of the agency is to make sure that the actions of companies comply with current consumer regulations and that consumer rights are respected (www.konsumetverket.se,2)

The Swedish Bankers' Association

The Swedish Bankers' Association is a trade association representing not only banks but also the finance companies and mortgage credit institutions owned by the major banks. The association has 32 members today, of which 11 are branches of foreign banks operating on the Swedish market. The main task of the trade association is to represent its members towards the authorities and other organisations as well as to analyse and propose new bills concerning the bank and finance area. The Swedish Bankers' Association also handles questions concerning common regulations for financial institutions both on a national and an international level and produces and publishes statistics and other kinds of information to inform the public about the Swedish financial markets. (www.bankforeningen.se,1)

¹ In Swedish it is called "Finansinspektionens författningssamling" and the abbreviation is FFFS.

Abstract

Bachelor Thesis in Business Administration, Financial Reporting and Analysis, School of Economics and Commercial law, Göteborg University, Spring Term 2007

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Title: Home Loans – A study of banks' lending to finance housing

Background and problem discussion: Over the past few years prices on housing have repeatedly hit the roof; in the news there have been reports about how there has, year after year, been a new all-time high for money spent on housing. The low interest rates are enabling people to afford large loans and hence to pay more for their housing. We would like to investigate what the market for home loans looks like and what rules the banks play by. We will focus on the market for home loans; nearly half of the banks lending today is to private persons and a great part of this sum goes to investment in real estate.

Aim of the study: The aim of this study is to investigate what role banks play concerning the elevation of prices on the private property market in the Gothenburg region.

Delimitations: The study is limited to look at the matter from a private person's point of view and in the Gothenburg area. The study mainly focuses on the traditional banks, and has been limited to comprise only three of them.

Method: Data for the framework was collected to find out how the situation on the market for home loans, current regulation and the situation on the real estate market looks today. The aim was to find out how banks are supposed to act. Published information was searched in books, articles, theses and on the Internet. After this interviews with three different banks were carried out, in order to find out how the banks really act. The information found during the interviews is gathered in the empirical section and presented bank by bank.

Analysis and Conclusion: The information gathered in the framework and the empirical section was then analysed. We have made comparisons between the way the banks are supposed to act and the way they act as well as the differences that emerged between the banks. In line with the aim of the study we have then answered our problem definition; what role do banks play concerning the elevated prices on the private property market in the Gothenburg region? The capital made available by banks is what enables prices on houses to rise, but it is also rising due to the economy in general being favourable. Due to low interest rates and the boom in the business cycle which we are now experiencing, people have been able to afford to take larger loans in order to pay higher prices for their housing. The price on real estate is decided by supply and demand and if someone is willing to pay the price for a house or an apartment, then is that price not to be seen as the real value?

Research suggestions: We would find it interesting to look into the matter of advertising on the market for consumer credits. It can easily be established that some banks put a lot of effort into marketing themselves. Does the marketing agree with the demands of current regulation for marketing to be neutral and moderate? Does the advertisement change along with the increased competition?

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1 INTRODUCTION

In this first chapter a brief background to the problem studied is given, followed by a problem definition where after the aim of this study is clarified. Finally, the delimitations of this study are given.

1.1 Background

Over the past few years prices on housing have repeatedly hit the ceiling; in the news there have been reports about how there has, year after year, been a new all-time high as for money spent on housing.(Åkesson 2007) The increasing prices are followed by an increased lending to finance the purchases of houses and apartments. At the end of 2003 the total amount of money in outstanding home loans was 1295 billion SEK (Bankföreningen 2004). In 2006 this figure had increased to 1670 billion SEK (Bankföreningen 2007), which constitutes an increase of outstanding home loans by 400 billion SEK in three years. Is this trend of increased lending to finance housing something to be concerned about? Maybe there is nothing to worry about; maybe it is just a sign of society being better off, having more money to spend. Or maybe; we should actually be a bit concerned. Comparing the development on the market today with what happened in the 90's, is history repeating itself?

Some analysts argue that we should be careful. They have the events of the 90's still fresh in their memory and they wonder whether or not we are heading down the same road again. In the 90's prices on investment properties grew sky high, until they fell rapidly dragging companies and banks down with them. Behind the crisis were different factors such as the business cycle at the time and also the development on the credit market. During the end of the 80's the Swedish construction, labour, real estate and credit markets were overheated. The overheated real estate market was closely connected to the development on the credit market, without which the increased property prices would not have been possible (Pettersson 1993).

From 1983 until 1986 there were three very important deregulations taking place on the Swedish credit market which had a huge impact on the real estate market at the time. First, a law obliging banks to have a certain amount of their capital in government bonds was abolished, freeing capital for the banks. Second, the regulation concerning what interest rate the banks were allowed to charge was also abolished, making it possible for the banks to compete by lowering their interest rates. Finally, in 1986, the regulation saying how much banks were allowed to lend was also revoked, which led to heavily increased lending to the public.(Pettersson 1993) The abolishment of these regulations enabled real estate investors to borrow money for buying properties, and as prices rose banks lent more and more money until the bubble burst and the properties lost their value and banks lost their securities. This was one part of the reason for which Sweden went into a depression during the beginning of the 90's.

As prices on private property have kept rising over the years, questions have been raised in the media concerning the increase. Some people worry about it being a bubble and whether or not it will burst and if so, what will happen? It is a fact that prices are rising and it is a fact that people are borrowing more money to buy houses and apartments. The low interest rates are enabling people to afford large loans and hence to pay more for their housing. However, there has been no deregulation recently such as the one during the late 80's which could explain the loan boom that we have experienced since 2000, which indicates that there are

differences between the events in the 90's and the development on the real estate market today.

The rising prices on today's housing market might not have the same background as the escalation of prices in the 80's, nor might it have the same resolution. The prices on private housing are decided by supply and demand and as long as people can afford, and are willing, to pay the prices demanded the prices will keep rising. There are no grounds for expecting a bubble to burst in the same way as happened in the 90's, as long as the economy stays stable. There is one common trait that we find interesting, though, comparing the 90's to what is happening today, and it is the role of the banks when it comes to the prices rising. In the 90's they lent money to the investors in order to buy investment properties, today they lend money to the common people in order for them to buy housing; both times their lending has led to heavily increased prices. Do the actions of the banks help create a risky state for consumers?

1.2 Problem discussion

With the rising prices for housing, people borrowing money to pay for their house/apartment are vulnerable should the prices fall as they did in the 90's. Today, in many cases, people borrow over the assessed value of their house/apartment as the market value is higher. Should the prices fall down to a level equal to the assessed value, as the level was 6 years ago², the borrowers might not get enough money back to cover their loan should they want to sell their house/apartment. On the other hand, what is to say that prices will fall? As long as there is a demand it should not be a problem, and as long as the economy stays stable there is no reason to believe that the demand will disappear. However, what happens if it does?

Banks are profit making companies, which have to pay dividend to their shareholders as any other company. Banks make money on two main things; the interest rates people pay on their loans and the fees people pay for the services used. The interest corresponds to approximately 50% of the banks incomes³, which means that lending money to the public is to a large extent what makes banks profitable. If loans are given away too easily and by that contribute to a rise in private persons indebtedting themselves, what is the banks' responsibility for this? Is the rise in prices a negative thing or is it just a natural development following a growing economy?

We would like to investigate what the market for home loans look like and what rules the banks play by. Is it possible to ascribe a greater responsibility to the banks, maybe even some kind of social responsibility, since they can affect the amount of capital available on the market and hence affect the amount of money people can pay for houses and apartments. We will focus on the market for home loans; nearly half of the banks' lending today is to private persons and a great part of this sum goes to investment in real-estate.

1.3 Problem definition

What role do banks play concerning the elevated prices on the private property market in the Gothenburg region?

² See figure 6 for more information on the price development in relation to the assessed value

³ Information from the annual reports regarding net interest income as a percentage of total revenue: Nordea 52%, Handelsbanken 50%, SEB 37% and Swedbank 55%.

In order to be able to investigate this question properly, we need to be able to answer the following questions as well in order to get different perspectives on the subject:

- What do the regulations facing banks look like?
- What are the banks' criteria for lending money to private persons?
- On what grounds do banks value the securities left for the loans, in most cases the mortgage deeds?
- Do banks have any form of social responsibility regarding that they are partly responsible for the amount of capital available on the market for private persons?

1.4 Aim of study

The aim of this study is to investigate what role banks play concerning the elevation of prices on the private property market in the Gothenburg region. The main purpose of this study is not to find the definitive answers to the questions posed above, if that is even possible, but rather to reason about the questions in the best conceivable way.

1.5 Delimitations

We will mainly focus our attention on the traditional banks as they dominate the market for home loans. We have been forced to limit our research to comprise only three banks as there was a time limit set for this thesis. We tried to choose banks with various backgrounds in order to get as wide a reflection of the market for home loans as possible. We are aware of there being alternative sources on the market for home loans from which people who do not qualify to be granted loans by the traditional banks can borrow money. However, these credit mortgage institutions represent a source of lending that is not seen as serious competition by the traditional banks and therefore we have decided not to include these sources of lending to any greater extent in our thesis.

Another delimitation of this study is that the focus is on the private property market in the Gothenburg area. There are two reasons for this; firstly that we are more familiar with this market since it is in our immediate surroundings which will probably make it easier for us to get in contact with the people relevant for our study, secondly due to the limited time on our hands which does not enable us to carry out a larger study. We realise that, as a result of our delimitations, the results of this thesis can not be applied to the entire Swedish market for home loans nor can it be generalised to be true for the entire Gothenburg market.

What we will focus on in this thesis is the role of the banks when it comes to the price development on the housing market. We do not plan to investigate what causes the prices to rise in general, but rather how the actions of the banks affect the price development. Therefore we will not take any other possible causes for the price increase into consideration in this thesis. We are aware of banks not being the only reason for prices to rise; still we find it interesting to see what their role is.

2 METHOD

In this chapter the methods used to fulfil the aim of this study are explained. The positive aspects, as well as the negative aspects, of the chosen methods are discussed, as are the affects of the choices made on the accuracy of this study.

2.1 Our procedure

When writing this thesis we started off by finding out how the market for home loans has evolved over the last couple of years and what regulations, laws and customs banks in Sweden are obliged to act in accordance with. We also learned about the development on the real estate market in Gothenburg. Second, we focused on how banks act in reality and what they think about the development in the financial sector and on the real estate market. In order to find out more about this we carried out interviews with three banks. Finally, we compared how banks should act with how they really act and discussed possible outcomes of their actions; both positive and negative aspects were discussed concerning how they act in reality in relation to how they should act. The planning of our work can be illustrated in the model below.

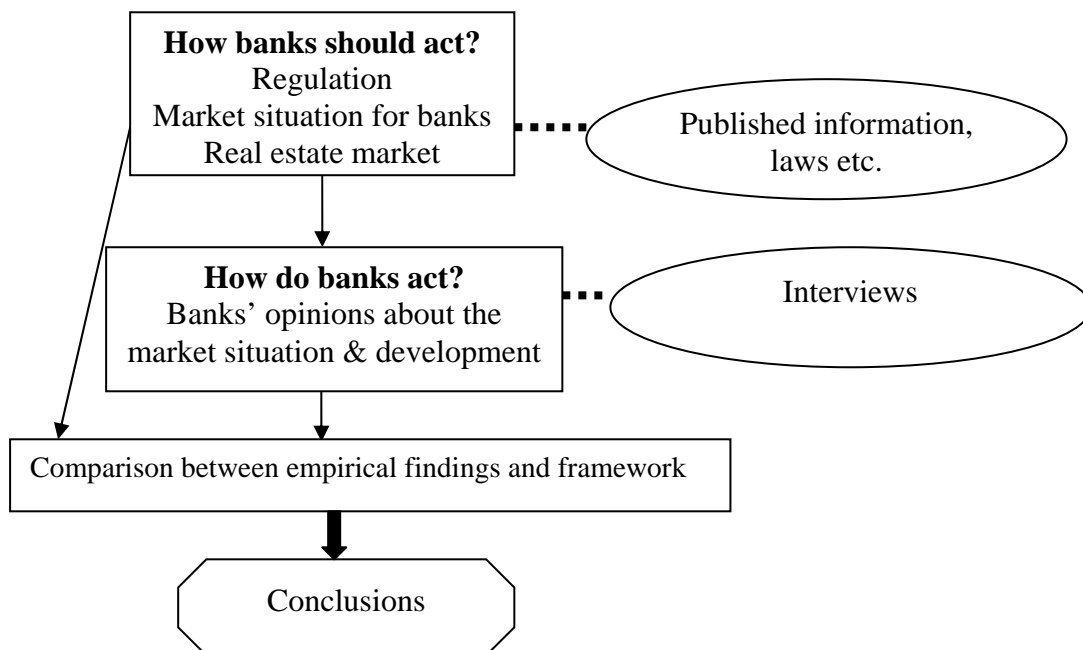


Figure 1, Our method procedure

2.2 Research for our framework

Our framework chapter consists of four main areas; the situation on the Swedish home loan market today, the rules and regulations that banks have to follow, the calculation of living expenses and the situation on the Gothenburg real estate market. We believe that finding out more about these four areas would give us the background and the understanding needed to carry out a study of our chosen topic. To gather the information needed regarding these four areas we had to use different material; ranging from books, theses, articles and Internet sites. It is true for both the books and the articles that the opinions can be divided, but we have done

our best to stay as objective as possible and to take into account the different perspectives of the authors.

To begin with, we found it crucial to get a greater understanding of what happened in the 90's. Even though this topic does not qualify directly under our chosen problem definition it is still of immediate interest since many people draw parallels between the events taking place in the 90's and the situation of today. The information found during this first part of our work, was primarily for our own understanding of how a financial crisis could evolve and it is used in the background and other parts of the first chapter of this thesis. With the intention to learn more about the Swedish financial crisis we mainly used books and theses. It was quite easy to find published information that discusses the historical aspects, since this has been a rather well debated topic.

When having learned about the historical aspects the next step was to look into what regulations banks have to act in accordance with. For this part of the essay, we collected most of the data by searching for published information on the Internet. In the framework chapter we made a description of the regulations we found most relevant to our study. We only used official sites, to ensure that the information was as objective as possible. Examples of those sites are the official web-sites of the Swedish Financial Supervisory Authority and the Swedish Parliament.

When learning about the regulations facing banks it became clear to us that it would be interesting for our thesis to also include a section that treats the calculation of estimated living expenses, as these are what banks base their decisions on when deciding whether or not to grant a loan. The Swedish Consumer Agency supplies consumers, as well as banks, with guidelines as to how to calculate the money that an average person spends each month. The guidelines, as well as some explanations to what is included in the figures, can be found in one of our framework chapters.

To learn more about how the situation on the market for home loans, as well as the situation on the housing market, has evolved over the last couple of years, we had to use a slightly different method to search for information than the one used for the historical aspects. There are some theses available, comparing what happened in the 90's to the situation today but their focus has mainly been on the real estate investors, rather than on the private person. As for books, it is hard to find any that treat the present situation. So, instead we turned to different associations which represented their market. For the information regarding lending made by banks we used the Swedish Bankers' Association and for the information concerning the development on the market for houses and apartments we used statistics published by the real estate agencies that had a majority of the market share. We have also been able to find information through newspaper articles in Dagens Industri, which we believe to be a trustworthy source of information.

2.3 Empirical data and analysis

If the research done for our framework helps answer how banks should act, the empirical data is used to answer how they really act. It is a matter of fact that it is rather complicated to find published information on how banks reason about whether to give a private person a loan or not, this is also true regarding how the valuation of securities in properties is being carried out. We wanted to get an understanding of the opinions and practical behaviour of the banks in order to receive deeper knowledge regarding the topic studied, which is why we chose to carry out interviews with some representatives from the Swedish bank market.

2.3.1 Empirical selection

Before starting our work to choose which financial institutions to focus on, we made a survey of what different alternatives there are on the Swedish market for home loans⁴. We categorised those into two different sections; banks and credit mortgage institutions. By banks we mean actors who carry out other financial services besides lending, i.e. savings of different forms, funds etc. Hereafter, when talking about credit mortgage institutions we refer to companies only focusing on house loans, not including the credit mortgage institutions such as Stadshypotek and Spintab which are owned by traditional Swedish banks such as Svenska Handelsbanken and Swedbank. We found that since the credit mortgage institutions still only has a small per cent of the market, they were not interesting to investigate to any greater extent in our thesis. Instead we wanted to focus on the banks. Due to the limited time when writing this thesis, we could not possibly interview all the institutions we have categorised as banks. Therefore, we had to choose three of them to meet for more detailed discussions. We tried to get in contact with three banks with as different backgrounds as possible.

We interviewed three employees, working at three different banks; Handelsbanken, Nordea and Länsförsäkringar Bank. Two of the banks, Handelsbanken and Nordea, were active during the financial crisis in the beginning of the 90's and the third bank, Länsförsäkringar Bank, was created after the crisis. Handelsbanken, was the bank that managed the crisis best, therefore we found it interesting to find out how they look upon the situation today. Nordea, another large player on the Swedish financial market, were also active during the early 90's but did not manage the crisis as well as Handelsbanken. Länsförsäkringar Bank is a rather new bank on the market and did not exist during the crisis in the 90's which made it interesting to look into how they handle the development on the real estate market today.

When we contacted the banks, our demand was to speak to someone who was well informed regarding the banks' loan policy. At Nordea we got in contact with Gunilla Andersson who is the private market manager at her office, situated in Gothenburg. At Länsförsäkringar Bank we got to talk to Magnus Andersson who is the credit manager in the Gothenburg and Bohuslän area. Finally, at Handelsbanken we interviewed a private advisor, Marie Sjöholm, working at Handelsbanken Första Långgatan. Due to the banks' decentralised organisation, the answers given in the interview can only be applied to this specific office. Therefore, when referring to Handelsbanken, or the bank, in the interview section we mean this specific office and not the Handelsbanken group, with the exception of the introduction paragraph concerning the bank.

The idea was for the respondents, due to their positions at the banks, to have profound knowledge as to the policies of the bank regarding loans. Therefore, we do not feel as if it can be seen as a disadvantage that Marie Sjöholm was not a manager but a private advisor, as she should be as aware of what the market for home loans looks like as the managers. We understand, however, that since we only spoke to one person at each bank, the result of the interviews will to a certain extent be coloured by the personal thoughts and ideas of the respondents. A more proper solution would have been to speak to more people at each bank, but due to our time limit this was impossible for us to perform.

2.3.2 Interviews

By using interviews we got the chance to ask questions about things that were hard to answer by looking at the web-site of each bank, but which were still crucial to our investigation. We

⁴ The financial institutions offering home loans can be seen in appendix 3

did not just want to find information about how they act, but also why they act the way they do. Our interviews took place at the bank branches where we visited the respondents, since Holme and Solvang (1997) says that interviews should be held in a place where the respondents feel at ease and comfortable because if the respondents feel that they are in an affected environment they are likely to give affected answers.

To make sure that there would be no misunderstandings regarding what was actually said during the interviews and to avoid that we would forget the exact formulations of the respondent, we chose to record the complete interviews. This was done by using our MP3-players, of course with the knowledge of the respondents.

We used open questions to the largest extent possible when carrying out the interviews. The reason for this was that we wanted to avoid for the respondent being controlled and led by our questions. Our purpose was not only to find the direct answers to the questions asked, but also to try to survey the thoughts and attitudes of the consulted bank employees. Using open questions is the best way of achieving those results (Jacobsen 1993). Before the interviews took place, the respondents received four⁵ different subjects which we planned to discuss during the meeting. These subjects were supposed to help us answer the questions in our aim of study. As our aim was to get spontaneous answers and thoughts from the respondents, we did not want them to have the chance to prepare what could be seen as "correct answers" according to regulations and policies.

Even though we had the intention to use open questions as much as possible, it was important to have a prepared interview manual before carrying out the interview (Holme and Solvang 1997). The manual contained the basic questions that we wanted to have answered during the interview session.⁶ Those questions were not to be handed out to the respondent, but to serve as our frame work and make sure that we got answers to all the questions we believe to be important for our investigation. It was essential for us to have a clear image about what we wanted to achieve with the interviews before they took place. Our aim was not to follow the manual to the letter as new and interesting questions could emerge during the interview. Rather, the manual was supposed to serve as a guideline so that we would not neglect any important questions and were reminded to ask the same questions to all of the respondents at our three different interview sessions.

2.3.3 Compilation of empirical data and analysis

After each interview session we sat down and listened through our recordings and wrote down what was said. We wanted to give as true a view as possible of what was said by the respondent. To really make sure that our text was in accordance with the view of the respondent, we sent them a copy of the text and asked them to read it through. If they had any objections, we tried to correct our text in such a way that both parties could agree upon it.

The questions posed during the interviews were divided into four main areas; the development on the market for home loans, the impact of rules and regulations, the requirements to be granted a loan and last but not least the valuation of securities. These four main areas were all used as headlines in the empirical part of the text, one bank at a time. Below each headline, we presented the answers given during the interviews. We structured the written versions of

⁵ The development on the home loan market over the last couple of years, the rules and regulations facing banks and how they affect the granting of loans, the requirements to be granted a loan and the valuation of securities.

⁶ The interview manual can be found in appendix 1.

the interviews in the same way for all three banks. Each bank got their own section where all four areas were handled and the answers were arranged in the same way in the different sections. This way it is easy to search between the headlines, should the reader wish to compare what was said at the different interviews concerning a certain question.

In the analysis section we summarized what the three banks had said during the interviews and compared their answers to each other. We also linked what was said during the interviews to the information that is presented in the framework for our thesis and discussed the differences from different perspectives. The analysis section is presented with the same main headlines as the empirical findings, although some subheadings differ.

2.4 The accuracy of this study

We chose to carry out interviews in order to answer the questions arising during the work process of this thesis. We have tried to communicate to the reader how we have received the information and how we have treated it in order to give the reader a chance to decide for him/herself whether or not he/she feels that the way we went about this was the right way, and also whether or not he/she feels that our result is trustworthy.

This study will be affected by us, the authors, as we see the reality through our own eyes. Different people can understand and interpret the same situation in various ways (Jacobsen 2003) and we are aware of the fact that our previous experiences and our values will affect how we interpret the information found while carrying out this study. It can also be said that the accuracy of our study can be reduced as the answers given to our interview questions might have been different had someone else been interviewed. It is very hard to stay totally objective to the information received during the process, however we have tried our best to carry out our study with open minds and without judging anything or anyone in advance.

The accuracy of our study can also be compromised by the area we have investigated. It is a rather sensitive subject and in some cases the answers given to us during our interviews might not really be reflecting reality. As competition increases banks might seek to act in a way that does not quite follow their internal regulations in order to attract clients; and we doubt that they would admit this to us. The answers given to us state what they should do according to external and internal regulations, but how they really act is in some cases different from what regulations state. If it is a desirable customer banks are willing to make exceptions to their rules in order to be able to grant the loan to the client and connect him/her to the bank.

3 FRAMEWORK OF OUR THESIS

In this chapter we present the framework for our essay, based on which the analysis of the empirical data is done. First, information regarding today's home loan market in Sweden is given. Second, there is a presentation of the rules and regulations which Swedish banks function under. Third, information is given regarding the figures given by the Swedish Consumer Agency. Finally, some information is presented regarding the situation on the real estate market in Gothenburg.

3.1 The situation on the Swedish home loan market today

The market for home loans is dominated by the four major banks in Sweden, which are Swedbank, Svenska Handelsbanken, Skandinaviska Enskilda Banken (SEB) and Nordea. As can be seen in the figure below, Swedbank has along with Handelsbanken the leading position on the market. They are followed by Nordea and SEB, which have rather equal shares of the market. Not far behind the major banks are SBAB. The loans given to the Swedish households are divided as follows among the largest actors on the market:

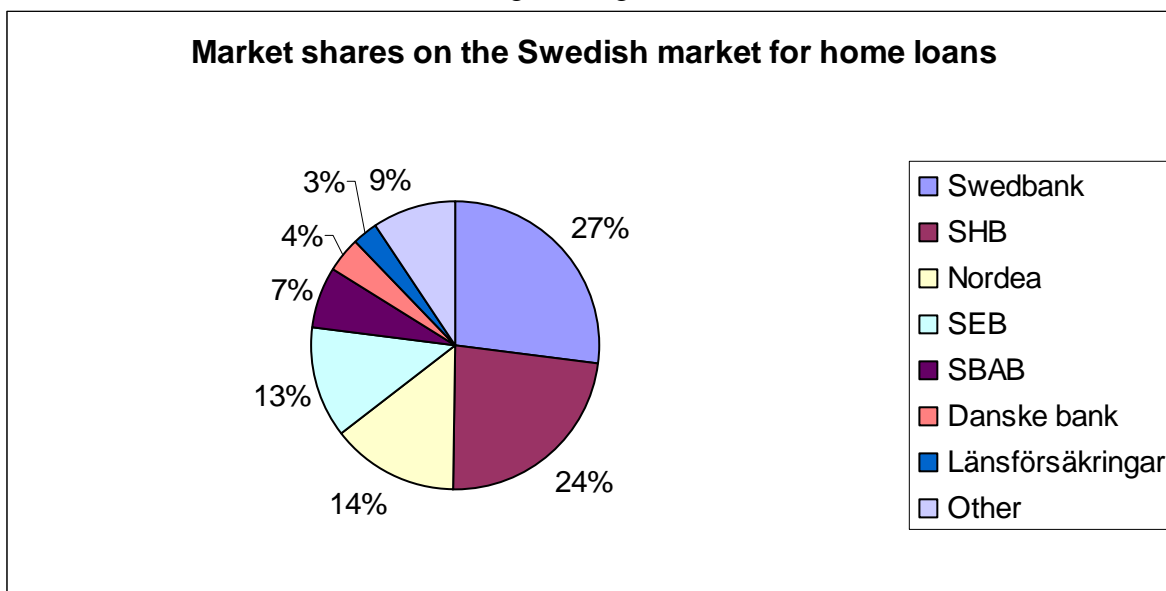


Figure 2, Market shares on the Swedish market for home loans 2006

(Econ 2007)

According to the Swedish Bankers' Association, the loans given by banks to finance the purchases of houses and apartments increased by 126 billion SEK during 2006 compared to 2005. The largest increase was in the lending to tenant-owned apartments, which increased by 21% followed by the lending made to finance housing which in turn increased by 11%. At the end of 2006, the total lending made by mortgage credit institutions to Swedish households was 1670 billion SEK. (Svenska Bankföreningen 2007) The increase in home loans given by financial institutions to the Swedish public in 1995-2005 is illustrated in the figure below;

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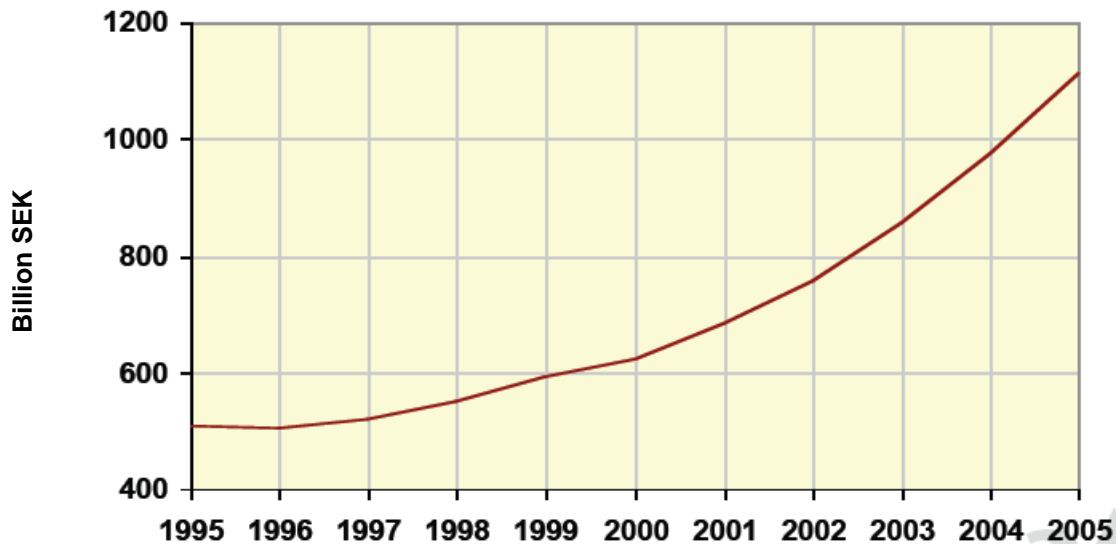


Figure 3, Debt in financial institutions 1995-2005

(www.scb.se)

Today, there are several different alternatives to choose among when a consumer is interested in borrowing money for buying a new home⁷. The banks are the largest players on the market for home loans but in the past few years new actors have emerged and the competition has therefore increased. When looking at the conditions given by banks and mortgage credit institutions on the home loan market, it can be seen that they do not differ a lot (www.compricer.se and www.pricerunner.se). The relation between the first and the second mortgage loan, the demand for a security and the interest rates are quite similar, with a few exceptions. The greatest difference noticeable is that the mortgage credit institutions all consider people with a bad record of payment as potential customers, while the banks generally do not grant loans to this segment. Some of the mortgage credit institutions charge their customers with interest rates higher than those of the banks, but this cannot be said to be true for all of them.⁸ The fact some of the new actors on the market for home loans grant loans even to those showing a record of non-payment of debt has opened up the opportunity to own a house or an apartment for a group of consumers that could previously not afford to buy their home as no bank would grant them a loan.

3.2 Regulation

When functioning as a bank in Sweden, there are certain rules and regulations to follow. The regulations facing banks and other financial institutions are in some ways stricter than the regulations facing companies in other sectors. Traditionally, Swedish banks have faced a strict regulation. For example, before 1985, the interest on loans was regulated by the government and there was also a limit to how much capital the banks were allowed to lend. After the deregulation of the financial market in the middle of the 80's, the lending increased (Econ 2007).

There are three main reasons why it is seen as important to regulate the financial market. The first reason is to prevent a system crisis. As the financial sector has a great influence on other

⁷ A brief compilation of the largest actors on the Swedish home loan market are listed in appendix 3.

⁸ The interest rates of the actors on the Swedish home loan market are shown in appendix 3.

sectors within the economy, it is very important for the society as a whole that the financial sector remains stable. The second reason is to protect the consumers and their assets kept in financial companies. Finally, the third aim of the regulations is to promote efficiency in the financial system. (www.riksdagen.se)

As Sweden is a member of the EU the government has to pass laws that ensure the implementation of the directives passed by the EU, e.g. Basel II. The aim of this EU directive is to ensure that banks all over Europe have a certain risk awareness and that they compete on equal grounds. The Swedish Financial Supervisory Authority, SFSA, is in charge of making sure that Swedish banks, and foreign banks acting in Sweden, behave as they should. SFSA publishes rules and regulations that banks, acting in Sweden, have to follow and they are also in charge of making sure that banks act according to the EU directives.

As laws and regulations facing banks are not very specific, banks need to have internal regulation stating for their employees how to handle different situations. Banks have internal guidelines for how the employees should work with customers and what kind of information they must provide the customer with, when he/she applies for a home loan⁹. However, even though the internal regulation is crucial to how banks act it is difficult to find information regarding it and it will therefore not be mentioned further in the framework section.

3.2.1 Basel II¹⁰

With an increased amount of transactions cross-borders the need for mutual rules and regulations has resulted in the Basel Accord, which is to be implemented in the EU member countries during 2007. The overall purpose of the directive is to increase the stability of the financial system and to create equal grounds for competition within the EU. (www.riksdagen.se) Basel II is built up by what is normally referred to as pillars. Pillar number one handles the minimum capital requirement, pillar number two discusses the supervisory review and finally, pillar number three treats the demand for market discipline.

Pillar number one discusses the minimum capital requirement which means that credit institutes and securities brokerage companies need to maintain a certain minimum level of capital. The capital is meant to act as a reserve to cover the risk of unexpected losses resulting from the credit-, market- and operational risks facing the institutes.(www.fi.se,4)

The new rules in Basel II, concerning how to calculate the capital to be held by banks, aim at a more direct reflection of the risks actually facing the banks. In the new rules, the different sets of risks are treated more comprehensively and given different risk ratios. This requirement does not only promote financial stability, it also gives a certain safety for consumers as it reduces the risk of the institutes no longer being able to fulfil their undertakings. Banks can calculate their minimum capital requirement through either using a standardised approach or, after having been given permission from the Swedish Financial Supervisory Authority, through an internal rating based approach, IRC-method. (www.riksdagen.se)

Pillar number two states that supervisors are required to ensure that banks have well functioning internal processes for ensuring that their capital held is adequate, and that they

⁹ The internal regulation of each bank can be found at each bank's web-site.

¹⁰ The first set of rules came out in 1988 but as it was considered to have flaws it did not take long until the work with Basel II had begun. After extensive work Basel II was finally signed in 2004.

have thoroughly evaluated their risk taking. In order to make this work a close co-operation will be needed between banks and the supervisors, which in Sweden will be the Swedish Financial Supervisory Authority(www.bis.org).

Finally, pillar number three states that banks need to be more open with how they calculate their risks and their minimum capital requirements in order to enable external parties to get a better understanding of the actual state of the bank and the risks that it faces. (www.bis.org)

3.2.2 The Swedish Financial Supervisory Authority and consumer rights

According to a report from the Swedish Financial Supervisory Authority (2004), the purpose of consumer protection is to increase the consumer's knowledge about the financial risks of loans. The authority is not to be considered a guardian regulating whether the consumer should take a loan or not. The aim of the organisation is rather to work for a situation in which relevant and useful information is presented to the consumer in order to give the consumer a chance to consider if the financial risks and costs of taking a loan are possible to handle.

An important aspect is that the information given regarding the loan should be understandable for the consumer. The SFSA emphasizes that only handing over documents is not enough, a dialogue between the consumer and the bank is necessary to ensure that the customer really understands the risk factor of a loan. This is something that cannot be regulated by law, instead it must be something that is seen as natural for the banks and the bank workers. Customers should be given information regarding different interest rates which can appear in normal business cycles, for example interest rates between 3 and 8 percent. In 2004 SFSA found that only a few banks really did this which led to a renewal of the SFSA's general guidelines on consumer credits¹¹ in 2005.

Testing the consumer's financial state

Since the financial crisis in the 90's the rules regulating the bank's lending have increased. Today, when a consumer applies for a credit, the credit institution is obligated by law¹² to get information on the consumer's solvency and to make an estimation of the living expenses for the consumer so as to make sure that he/she can actually afford the loan. When the credit application is for a tenant-owned apartment, the credit institute should also obtain information regarding the tenant-owner's association's accounts (*FFFS 2005:3*§3.2.3).

The credit institution should get information about the consumer's solvency from one of the credit rating agencies, such as Upplysningscentralen, UC. The information from UC gives the bank an idea of the consumer's solvency; his or her income over the past two years and whether or not the consumer has had problems paying his bills in the past. There are two underlying reasons why banks should get information on the consumer's solvency; to prevent consumers from indebting themselves too heavily and to avoid credit losses for the bank, and thereby protecting the deposited money of other bank customers. The solvency of the consumer is investigated in order to see that the person has the financial stability needed to handle the extra costs of having a loan. An exception to this rule is when the consumer is already known by the bank; in that case there is no obligation to get information about the solvency of the customer.

¹¹ In Swedish: Finansinspektionens allmänna råd om krediter i konsumentförhållanden

¹² Lag 2004:297 om bank- och finansieringsrörelse

Banks also have to do a calculation of increased living expenses and they have to see that everything adds up. According to law¹³ the current and future capacity to pay for the loan should determine whether or not the credit is granted. Even if the consumer leaves a security, i.e. a mortgage deed, the capacity to pay must be determined before being granted a loan. The credit institution is well advised to make a cost estimation based on the incomes and expenses of the consumer. Even though there are laws stating the banks' obligation to check the consumer's ability to repay the loan, there are no specifications as to what is acceptable and what is not concerning how to calculate the estimated living expenses. The living expenses can be based on the guidelines given by the Swedish Consumer Agency or by calculations made by the credit institution itself. The person applying for the credit should be informed about how different interest rates and tax reforms will affect the expenses occurring due to the loan. If the consumer is part of a household of more than one person, the household should be considered as one unit and all its assets and liabilities should be taken into consideration when looking at whether or not a consumer should be granted a loan.
(www.konsumentbankbyran.se)

Marketing of consumer credits and unreasonable agreements

Marketing and information regarding credits should be neutral and moderate. A consumer should not be misled by the information given, on the contrary he/she should be aware of the credit's influence on the private economy (*FFFS 2005:3§2.4*).

If it can be proven that a credit institution has granted a credit that should never have been granted in the first place, i.e. because of the consumer lacking capacity to pay, the credit could be partly or completely written off according to Swedish contract law § 36. This only applies to the circumstances existing on the day when the credit was issued. Events occurring after this date, which could not be anticipated by the credit institution i.e. unemployment, should not be taken into consideration when investigating whether or not a bank granted a loan that should not have been granted. (www.konsumentbankbyran.se)

3.2.3 The European Agreement on a voluntary Code of conduct on pre-contractual information for home loans¹⁴

The Swedish Bankers' Association issues the Swedish version of the European Agreement on a voluntary Code of conduct on pre-contractual information for home loans¹⁵. The Code is part of a common European agreement, negotiated by the European associations of consumers and the European Credit Sector Associations. The Code is voluntary and discusses the information given to borrowers regarding home loans. The purpose of the Code is to make it easier for the consumer to evaluate and compare different loans offered on the market.

The Code has been signed by the four major Swedish banks, Handelsbanken, Nordea, SEB and Swedbank as well as by some of the smaller banks i.e. Länsförsäkringar Bank and IKANO banken. The banks have put together an information folder for consumers, where the general terms for house mortgages are explained.(www.bankforeningen.se,2) The Code also contains a European Standardised Information Sheet. (www.bankforeningen.se,3) The aim of the sheet is for all banks to present the information to the consumer in a standardised way, which is also supposed to make the comparison between different alternatives easier for the consumer.

¹³ Lag om bank- och finansieringsrörelse 8 kap. § 13 and Konsumentkreditlagen § 5a

¹⁴ For further information see appendix 2

¹⁵ In Sweden, the Code is often referred to as "bolånekoden"

3.3 Calculation of living expenses¹⁶

Each year the Swedish Consumer Agency calculates reasonable costs of living for the most common household expenses. The figures given by the agency gives the public a notion of the average costs per month for men, women, children and households. Their calculations are not for a minimum standard of living nor do they allow for luxury. They correspond to about 30% of the total consumption of the household; the remaining 70% is made up by costs of living, car, child care, vacations, hospital care and dental care etc. They calculate the money people spend on groceries, clothes and shoes, spare time activities, hygiene, child and youth insurance, consumables, furniture and other equipment for the home, electricity, telephone, TV, newspapers and home insurance.

The costs for groceries are based on a four week menu which contains meals of both raw material and pre-cooked dishes. The costs for adults are calculated based on a low physical activity, if one does sports the figures need to be increased by 70 SEK, according to the Swedish Consumer Agency. If the person is a single's household 100 SEK is to be added as a single person buys smaller packages and more food is thrown away.

As for the calculation of costs due to shoes and clothes, it also contains dry cleaning, shoe repairs and accessories such as hand bags, watches and umbrellas. When it comes to spare time activities the figures include toys, CD's, books, skis and costs for bikes. Hygiene expenditures contain the spending on soap, tooth paste, diapers and visits to the hairdresser. For women of less than 49 years an additional 30 SEK is included, which is to cover expenses for tampons and pads.

The figures for the child and youth insurance include a health and accident insurance. When looking at the costs for home insurance it is important to be aware that it varies depending on where the house is located. Consumables include the spending on, for example, detergents and toilet paper. Furniture and other equipment for the home contains the spending on furniture, household equipment, TV, computer etc. Telephone, Internet, newspapers etc also include the spending on letters, cards and stamps etc. As for the estimated cost for electricity the usage is the estimated usage in a rented flat, and the numbers are from 2004. (www.konsumentverket.se,3)

3.4 The situation on the Gothenburg real estate market

The prices of all kinds of real estate, both tenant-owned apartments and houses, have increased over the last couple of years. During the 12 month period between May 2006 and April 2007, 5724 tenant-owned apartments were sold in the Gothenburg area and the average price of these was 21539 per square meter which is an increase of about 5%.(www.maklarstatistik.se,1) Statistics on the development on the house market in the Gothenburg area during the period May 2006 - April 2007 show that 1774 houses were sold and the average price was around 2.5 million, which means that the prices on houses have also increased by 5%.(www.maklarstatistik.se,2)

The total turnover on the real estate market increased in 2006, partly due to prices having increased but also due to there having been more conveyances during the year. Reorganisations from rented flats to tenant-owned apartment are also more common today which has also increased the turn-over. (www.maklarsamfundet.se)

¹⁶ For further information on the actual figures given see appendix 3

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The figure below shows the price development for tenant-owned apartments in Gothenburg during the years 1996-2006. As can be seen in the figure the cost per square metre has doubled since 2001.

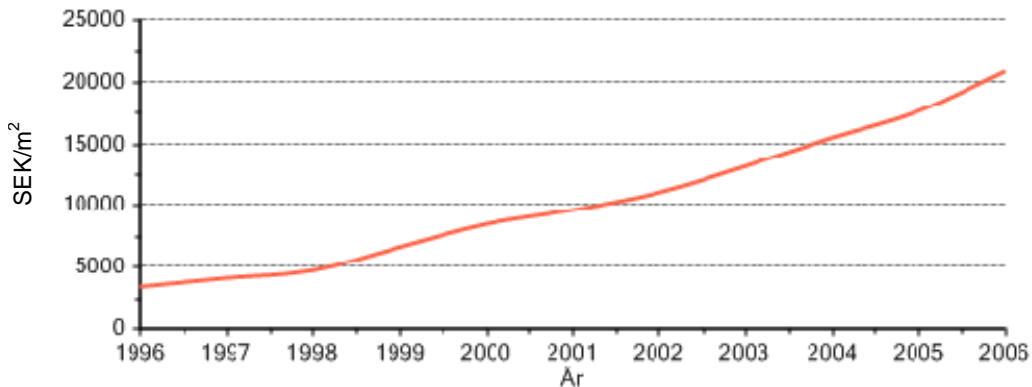


Figure 4, Price development for tenant-owned apartments 1996-2006

(www.maklarstatistik.se,1)

Figure 5 shows the price development on houses in the Gothenburg area during the years 1996-2006. K/T is the average of the purchase price and the assessed value which means that since 2001 the purchase price on houses has been above the assessed value and the curve is still up going.

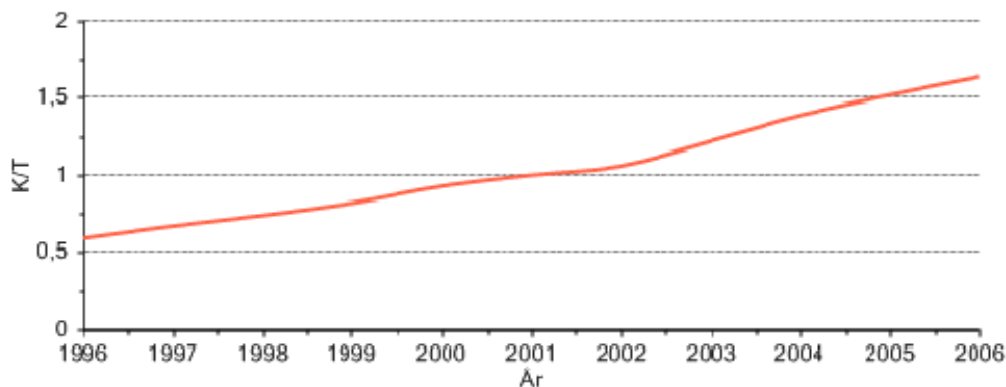


Figure 5, Price development for houses in the Gothenburg region 1996-2006

(www.maklarstatistik.se,2)

4 EMPIRICAL FINDINGS

In this chapter the findings from the interviews are retold. First, the information received considering how the banks look at the development on the market for home loans is presented. Second, we present the banks' view on what impact current rules and regulations have on their actions. Third, the requirements to be granted a loan are stated and lastly we present the views of the banks on how to value the securities left for the mortgage loan.

4.1 Nordea

Nordea is one of the major actors regarding financial services on the Nordic market. The company has around 10 million customers in the Nordic countries and over 1200 branch offices. The Swedish state is the largest shareholder with 20% of the capital. The organisation is divided into three different business segments: Retail Banking, Corporate and Institutional Banking and Asset Management & Life. Every area is responsible for their profit making and their customer relations. Retail banking, which includes home loans to private persons, is the largest area and contributes with 72% of the operating profit. (Nordea's annual report 2006)

4.1.1 The development on the market for home loans

Nordea has noticed an increase in the amount of money lent to home loans during the last couple of years. Nordea believes this to be due to the rise in property prices together with the fact that many blocks of flats are being transformed into tenant-owned apartments. Another explanation could, according to Gunilla Andersson, be that the society of today is more consumption oriented.

According to Gunilla Andersson the bank has noticed that many customers, when borrowing to buy a home also borrow to renovate, enlarge or refurnish it. She believes that some customers apply for a loan slightly larger than the one they actually need for the renovation, enlargement or refurnishing in order to be able to go on vacations etc. This is, however, not something that customers mention to the bank when applying for the loan. In the short term it is less expensive for the consumer to borrow money with a security of a mortgage deed, than it is to borrow money through an ordinary consumption credit.

Gunilla Andersson says that there is severe competition on the market for home loans today. This has mainly resulted in a lower margin for the bank. Regarding the bank's competitive situation, Gunilla Andersson believes that it is coping with it quite well and that the bank is able to control its situation to a large extent. Of course, the bank has to lower its margin as competitors lower their prices, but that is considered natural since Nordea cannot expect the customers to pay a higher price than that offered by other banks. Banks need to be attentive to the market as it changes from day to day. Some clients come to the bank wanting to negotiate the terms, for example they might have been granted a loan at another bank. However, if Nordea cannot get the calculation of living expenses together they are not interested in fighting over the customer. Gunilla Andersson considers the bank to have good grounds for competition as it can decide a lot on its own. In today's changing world it is important to always be aware of the changes in the financial world.

The reason why banks compete for home loans, even though it is today a low margin product, can according to Gunilla Andersson be explained by the fact that the banks hope for the customers to also use other, higher margin products that the banks offer.

Nordea sees the phenomena with more mobile customers as a large problem. Nordea wants for its customers to have all their businesses in the same bank, i.e. wages account, savings account and mortgage loan. The bank is not really interested in any other type of customers. Nordea offers its customers different concepts with benefits if they use more than one of the bank's products; this is in order to convince the customers to be loyal to the bank.

According to Gunilla Andersson, Nordea has not yet noticed the increased competition due to the new mortgage credit institutions emerging on the market for home loans as these companies do not necessarily look to compete for the same customers as the bank. The customers that apply for home loans at the mortgage credit institutions are primarily those who do not meet the requirements to be granted a loan by Nordea. The competition might, however, become more noticeable in the future especially on the consumption credit market.

4.1.2 The impact of rules and regulations

The laws concerning consumer credits are today looked upon as something natural. All customers accept that the banks order a UC report on them before granting a loan. Gunilla Andersson says that the credit reports might have been a problem at smaller offices on the country side before, but today it is generally not believed to be a problem anywhere in Sweden as customers know that they will not be granted a loan without a credit report having been issued.

The calculation of living expenses is a very useful tool for Nordea when deciding whether the customer can really afford the credit or not. The bank is not allowed, according to Swedish contract law § 36, to lend money to a consumer that cannot afford it, even if the customer has a good security. If the bank does lend money to someone whom they should have realised not able to afford the loan, the bank itself can be forced to pay the loan. Therefore, it is of great importance that the calculation of living expenses is conducted in a proper way.

Gunilla Andersson does not believe that the new Basel II regulations will affect the conditions for home loans very much. However, it is mentionable that she is not very well-informed of the actual processes of Basel II. She says that the bank will perhaps be able to lower their margins a bit more, but since the margins are already low, this will not have a great effect. Nordea does not yet seem to have begun their work of rating customers based on the actual risk they pose.

When the security for the loan is a tenant-owned apartment, the bank reviews the accounts of the tenant-owner's association. Gunilla Andersson says that this is highly important when blocks of flats are reorganized to tenant-owned apartments, which today is a common occurrence.

Gunilla Andersson says that Nordea's internal regulations have become stricter recently. This might be a side effect of the low interest rates which have lead to a greater demand for loans and hence increased lending. One example of the stricter regulation is that the interest rate used to calculate whether or not the consumer could afford the loan used to be 5%. About one and a half year ago the calculated interest rate was raised to 8% over night. This means that the demands placed on the consumer became stricter.

4.1.3 The requirements to be granted a loan

The first thing the bank does when someone applies for a loan is to investigate the customer's solvency by ordering a UC report. If the UC report comes back ok the bank moves on and

makes a calculation of the client's future living expenses, taking into account the increased costs due to the loan. The cost estimation is central when it comes to Nordea lending money or not, the client needs to pass the calculation in order to be granted a loan.

When the financial counsellors at Nordea do a calculation of estimated living expenses, due to a housing loan, they use an interest rate of 8% and a 50 year amortisation plan. Customers can, however, get the first five years free from amortisation and they are not forced to amortize after the first five years have passed either. Whether or not a customer amortizes is negotiable. The reason for Nordea calculating with an interest rate of 8% despite the low interest rates of today is that it is hard to know how the interest rates will vary and therefore the bank finds it better to imagine a worst case scenario in order for both the bank and the customer to be able to feel at ease even if the interest rates vary slightly.

The important thing for Nordea when deciding whether or not to grant a loan is that the customer must be able to afford paying for the loan. The customer needs to have space in his/her economy to be able to handle the additional expenses that a loan represents. If not, the bank does not grant the loan. Since everyone have different ways of living, some of the general numbers used in the cost estimation concerning a car, furniture, food, clothes and pleasure etc can be discussed between the customer and the bank. For example, if a customer does not own a car the costs estimated for having a car can be adjusted into costs for having a tram card. However, the numbers for food, clothes and pleasure are not negotiable. Some clients come to the office looking to bargain the numbers in the calculation with arguments such as "we do not eat that much", "we do not spend that much on pleasure" etc. Gunilla Andersson does not think that this is a good way of handling the calculation though. The calculation is in the best interest of the customer and if he/she cannot afford the loan with the given numbers then he/she should consider an object which is less expensive. It is not a good idea to cut down on basic spending just to be able to buy a house; the client must afford to live.

When granting a loan the bank is only interested in the present time, as the future is impossible to predict. Nowadays a customer does not have to have a full time employment to be granted a loan, this is due to the employment terms having changed in society. Earlier, a full time employment was the usual way of employment, but in today's society there are, for example, an increased amount of people who have employments on a project basis. This means that less people would qualify for being granted loans had the banks required a full time employment. What counts today is the income, regardless of what kind of employment you have you need to be able to show income statements proving that you have a steady income. In some cases it is an advantage to be two people taking the loan, but if the customer can pass the calculation of expected living expenses on his/her own then the bank will grant the loan. Mostly though, two people are needed to pass the calculation, especially with prices at today's level.

4.1.4 The valuation of securities

Nordea assumes that the purchase price is the correct value for the property. The bank has a computer system, which shows all purchase prices for houses in Sweden and through this a value can be estimated for the property. The same statistics are nowadays also available for tenant-owned apartments. The bank runs the computer simulation for all objects. If the system shows deviant values for a house or an apartment, Nordea also has the possibility to turn to a professional valuer, who goes and has a look at the object. The bank has a few people whom it trusts and sees as neutral. The valuers can be estate agents or other external professionals. It

is important that the value is not overestimated. There can be situations where the purchase price is lower than the real value of the property. For example, sometimes children buy houses from their parents. Nordea then accepts the purchase price as the value of the security.

The customer can be granted a loan of up to 90% of the value in a first mortgage loan. If the customer has good conditions regarding repayment, it is negotiable to lend even the last 10%, but then not as a first mortgage loan, but at a higher interest rate. The valuation of the securities is important but the bank focuses mainly on the customer's income and if he/she can pay the costs of the loan.

4.2 Länsförsäkringar Bank

Länsförsäkringar Bank consists of 24 regional insurance companies, providing customers with insurance and financial services. The customers of Länsförsäkringar are also the owners of the regional companies. In 2006 the bank had the most satisfied mortgage loan customers compared to other mortgage lenders on the Swedish market, according to SKI¹⁷. The bank increased its market share for mortgage lending to private homes and tenant owned apartments from 2,9% to 3%. (Länsförsäkringar's annual report 2006)

4.2.1 The development on the market for home loans

Länsförsäkringar has noticed a large increase in home loans during the last couple of years. This is believed to be mainly due to the rise in property prices. Today, however, the bank experiences a stagnation as for the amount of money being lent to consumers. The reason for this is that Länsförsäkringar used to be an actor on the market, who together with SBAB, helped reduce the price of home loans and thereby recruited many clients from other banks. When the other banks realised that they were losing customers to them, they started to lower their prices as well. Sometimes the other banks lower their prices to an extent that makes it impossible for Länsförsäkringar to compete. Overall the amount of money lent is still increasing, though, despite the increased competition, something that can be explained by the continued increase of property prices.

Regarding the bank's competitive situation, Länsförsäkringar believes itself to be a bit worse off than its competitors at the moment. This can be explained by the margin; Länsförsäkringar is today buying money a bit more expensively than other banks. This means that the bank has to charge its customers a little bit more in order to cover the expenses. The bank has noticed that customers are much more mobile today, mainly because of the bank having managed to attract many of the non-faithful customers. Still, a strong desire, if not to say a demand, is that the customers use more than one of Länsförsäkringar's products.

Länsförsäkringar does not experience a lot of competition from the credit mortgage institutions emerging on the market today. The mortgage credit institutions mainly recruit the customers Länsförsäkringar was never keen on in the first place.

4.2.2 The impact of rules and regulations

Concerning the laws and regulations facing banks, Magnus Andersson thinks that it is a good thing to have common regulations all over Europe. This is much due to the fact that this will help Europe prevent another crisis like the one that struck Sweden in the 90's. He also sees the law of consumer credit that emerged after the financial crisis in the 90's, as something

¹⁷ Svenskt Kvalitetsindex

good and something that has to exist and be followed in order for the financial market to function. Magnus Andersson used to work with loans that had not been repaid during the last crisis, and has therefore a positive attitude towards the demands of ordering a UC report and performing a calculation of living expenses. Still, Länsförsäkringar admits that there is room for the bank's own interpretations despite the regulations. Areas leaving space for the bank's own interpretations are such as on what level to place the living expenses in the calculation. The bank believes its own interpretations to be a bit stricter than the ones of other banks operating on the market.

Länsförsäkringar has not yet observed a large change originating from the new Basel II regulations. According to Magnus Andersson, the lowered minimum capital requirement might help free money that can be used for lending later on. The net effect of the new regulations might not be so big, though, as banks will have to reserve money for the promise loans given to customers, which they are not obligated to do at the moment. Hence, the bank believes that the new regulations will affect the banks more in the future, especially the possibility to rank customers differently and evaluate them separately. This will mean that a bank can charge a higher interest on a customer that constitutes a greater risk. Länsförsäkringar has been approved by the Swedish Financial Supervisory Authority to use an IRC-method of rating customers. This means that they will be able to rank their customers using a scale that they themselves have designed. The bank will start to use the model in the beginning of next year.

When operating as a bank, there is also a need for internal regulation. The board of directors at Länsförsäkringar can issue a warning to an office or a person that neglects their undertakings. As the board is personally responsible for the actions of the bank, it is obvious that there is a need for them to be able to control the employees by using the internal regulation.

When the credit application is for a tenant-owned apartment Länsförsäkringar always reviews the accounts of the tenant-owner's association. This is in accordance with the Code of statutes provided by the Swedish Financial Supervisory Authority.

4.2.3 The requirements to be granted a loan

In Länsförsäkringar's calculation of estimated living expenses the calculation is made using an interest rate of 7%, which can be considered rather high today with the actual interests people pay being around 4%. However, the bank uses a higher interest rate in the calculations for the security of both the bank and the customer. Historically, an interest rate of 7% is not something unusual in Sweden and the bank wants to see that the customer can afford an increase of the interest rate to that level.

In the calculation of living expenses, costs for food, hygiene and pleasure etc is taken into account. The guideline figures used by Länsförsäkringar are based on the figures given by the Swedish Consumer Agency. Some of the figures are, however, changed by Länsförsäkringar in order to, in the bank's opinion, better reflect reality. When calculating the living expenses, Länsförsäkringar requires for the client to have 6000 SEK per adult and 2500 SEK per child to cover the expenditures taken into account by the guidelines given by the Swedish Consumer Agency. According to Magnus Andersson, the figures can be discussed, and exceptions from them can be made if there are circumstances which are not taken into account by the calculation.

The customer can find the estimated cost calculation on the Internet and fill it out by him/herself. The calculation on the Internet does, however, differ from the one used by Länsförsäkringar in the Gothenburg region when counselling a customer which means that a customer can be "granted" a loan on the Internet according to the calculation but later be rejected when at the bank. A part of the explanation why the figures in the Internet version differs from the ones used by Magnus Andersson and the other financial advisors in his area, is that there are 24 banks sharing the web-site and they all have slightly different conditions which all have to be taken into account in one calculation. When having the customer at the office the bank will discuss the reality facing the customer, and hopefully make the consumer realise his/her limitations.

When it comes to housing loans Länsförsäkringar prefers there to be two people signing the loan and that they are both full time employed. Preferably the incomes are evenly divided between the couple so that they are not totally dependent on the income of one of them. For both to be signing the loan gives both the bank and the loan takers a better security as it is less likely for two people to fail paying for the loan. Should they, however, not be able to pay for the loan the bank can claim the money from either one of the two which increases the bank's security.

According to Magnus Andersson, not many customers have enough knowledge as to what it means to own a house as for additional costs at the time of buying and how to handle unpredicted costs later on. It is therefore important for the house owners, as well as for those owning their apartment, to have a reserve to use when something unpredicted happens. However, Länsförsäkringar do not ask for a certain amount of savings to function as a reserve, as needs differ from case to case.

4.2.4 The valuation of securities

It is important that the security given for a loan has been assigned a proper value. However, it is first when an object is sold, that the correct market value is known. The most central thing when assigning a value to a property is, according to Magnus Andersson, its location. Through statistics, the bank can see all selling prices for properties in Sweden. The bank can also do a computer simulation for a certain object. If the computer simulation shows a deviant value from the actual selling price, the bank has the possibility to hire a professional valuer in order to get a more correct value. Länsförsäkringar tends to accept the purchase price as the correct value of a property, unless there are large deviations compared to the computer simulation, as it is the market price decided through supply and demand.

4.3 Handelsbanken

Handelsbanken is a major player in the Swedish financial sector. After the financial crisis in the beginning of the 90's, the bank was the only bank which did not need to discuss support from the state. Today the bank has 458 offices around Sweden, but the bank is also active in other Nordic countries and in Great Britain. They also have representation offices in other parts of the world. An important part of the bank's strategy is to have a strongly decentralised organisation. The bank delivers all kinds of financial services; from private banking to investment banking. The objective of Handelsbanken is to have a better profitability than other listed Nordic banks. (Handelsbanken's annual report 2006)

4.3.1. The development on the market for home loans

Handelsbanken¹⁸ has noticed a great increase in the property prices, and thereby also the lending, during the last couple of years. As the bank has a decentralised organisation, the employees get to know their local market and customers very well, and have clearly noticed a rougher market during the last years. People are willing to pay more for their housing today and they accept that some areas are expensive to live in and if they want to live in that area they have to pay the price, even if it is a high price. There has also been a tendency for people to not be very interested in buying objects that need a lot of renovation; people prefer to pay more and get a house or tenant-owned apartment in good shape.

The bank's primary goal is not to fight to get a larger market share, but to have a good and stable portfolio of customers. Handelsbanken does not put any effort into marketing itself, unlike some of its competitors. However, Handelsbanken has experienced that some customers, influenced by the commercials of other banks, ask Handelsbanken if it can give them the same advantageous conditions as those offered by other banks. Handelsbanken tries to meet the conditions given by other banks in the best way possible, but emphasises that Handelsbanken always sets an individual interest rate based on the customer in question.

Handelsbanken is comfortable with its competitive situation. The bank has had very satisfied customers in the past, and hopes for this to continue in the future. Handelsbanken puts lots of effort into giving good service to its customers. In exchange for good service, the customer might not care about a small difference as for the interest rate, whether it is in their favour or not. This, of course, differs from person to person. Some people only look to find the lowest cost and it is always the customer who has the final say in where he or she decides to place his or her money.

Handelsbanken does not think that it is losing many customers to the new companies emerging on the market. Their main competitors are the other major banks and SBAB, sometimes they lose customers to those other banks, and sometimes they gain some from the others.

Handelsbanken does not see the phenomenon with mobile customers as a problem. Still, the aim is to create a long term relationship with the customer, preferably a life long relationship. The bank demands for the customers to have all his/her financial matters in one bank, Handelsbanken, i.e. savings account, wages account, funds and retirement annuity. This is a demand in order for the customer to be able to take part in the advantageous interest rates and terms that the bank offers. The bank is not particularly interested in a person just placing their house mortgage in the bank.

4.3.2. The impact of rules and regulations

According to Handelsbanken, the market for home loans is not very heavily regulated compared to other areas within the bank. As an example, the documentation process does not have to be as extensive regarding home loans, as when a customer gets advice on how to place his or her money. One of the most important regulations within lending is the Swedish contract law § 36, i.e. that the bank has to make sure that the consumer can really afford the credit given. Handelsbanken also acts according to other current regulations, for example they order a UC report on every customer being granted a loan.

¹⁸ We would again like to clarify that when writing Handelsbanken, or the bank, in this text we refer to Handelsbanken Första Långgatan and not to the Handelsbanken group.

One new thing in the area of consumer regulation is the newly implemented European Agreement on a voluntary Code of conduct on pre-contractual information for home loans. Handelsbanken does not see this as something odd; since Sweden is a part of the European Union it is only natural to adopt common regulations. However, the bank says that the new regulations might be a bit more time consuming, but at the same time it is a good thing that the regulator puts the customer in focus.

Handelsbanken has not experienced differences in lending terms following from Basel II. However, it has had an impact on the way the bank works. Handelsbanken has been approved by the Swedish Financial Supervisory Authority to rate its customers by using an internal rating system. Handelsbanken started rating the customers into different categories about a year and a half ago, even though Basel II has only been mandatory for a short period of time. The reason for the early start was for the staff to become familiar with the new system. Each employee of the bank is responsible for the rating of his/her customers. The rating is performed according to predetermined values, but there is also an influence of the staff's own judgement as they are the ones making the final decision. As Handelsbanken has always used a system of individual interest rates, the bank looks positively upon the new Basel II regulations.

One part of the internal regulation at Handelsbanken is that the bank always takes the repay ratio of the employee's clients into consideration when deciding the amount of capital an employee is allowed to lend.

4.3.3. The requirements to be granted a loan

Handelsbanken orders a UC report on its customers, as it is obliged to do so according to Swedish law. If the consumer does not show a bad record of payment the next step is to make a calculation of living expenses. Handelsbanken calculates with the interest rate for a five year loan, which today is about 4.95% and then add about 1.5% to that interest rate. The calculations made in order to decide whether or not to grant a loan is divided into two steps. The first step is to calculate what the interest and the amortisement of the loan will be. The second step is to calculate the living expenses for food, amusement, clothes etc. The figures for this second part of the calculation are taken from the Swedish Consumer Agency. The figures can be discussed between the counsellor at Handelsbanken and the client, but the client needs good reasons for the bank to rethink the original figures. If the client has money left after these two steps a loan might be granted. The customer can find a calculation for estimated costs on the Internet and fill it out at home, but just because he/she ends up with a positive answer on this version it does not guarantee that the bank will grant the loan once at the bank. The bank believes that the clients are well informed about their financial situation and about the impacts of taking a loan so it does not see rejecting clients who clearly cannot afford the loan as a problem.

The clients do not have to have full-time employment to be granted a loan but they need to have a steady income. Should the person applying for a loan work as for example a substitute teacher that might be qualification enough as there is often a shortage of teachers which means that the person can be expected to have a more or less steady income. The financial counsellor at the bank will, in uncertain situations, get in touch with the employer of the person applying for the loan in order to find out how uncertain the employment is and whether or not the person can be expected to receive a salary from the employer in the future

For an employee at Handelsbanken to grant a loan to a client they need to be able to show that the client is capable of paying back the loan. If this cannot be proven the loan cannot be granted by Handelsbanken. Handelsbanken does not let the client borrow money for the down payment on the house or the apartment, nor do they lend money to pay for the mortgage deed or the entry into the land register. If the client uses up his/her last savings on these three items Handelsbanken wants for the client to start a savings plan in order to save up to a new reserve of savings in case of unexpected expenditures.

4.3.4. The valuation of securities

Handelsbanken normally assumes that the purchase price is the correct value for a property. There can be situations when the purchase price is not the correct value, for example if a customer wants to buy a tenant-owned apartment for 3 million in an area where other, similar, properties are sold for less. If this is the case the bank can hire a professional valuer to establish a more correct value. Handelsbanken has its own valuers and they are also cooperating with some real estate managers in Gothenburg.

The reason why the bank cannot approve a loan if they believe the price to be an incorrect value is that it is a great risk for the bank as well as for the consumer. If he/she were to sell the property they might risk to get paid less for the apartment/house than what they have in mortgage. Of course this is not a desirable situation for the bank or the customer.

If a private person buys a tenant-owned apartment directly from another private person, without going through a professional estate manager, the employees at this branch office do some extra investigation to see whether the purchase price is the market value or not. One way of doing this could be to contact the tenant-owners' building society and ask them if the client can borrow 75% of the purchase price as a first mortgage loan which he/she does not have to amortise. These 75% of the purchase price are considered a safe investment as the bank expects at least this much to be received if the house were to be sold at an executive auction. 15% of the purchase price can be borrowed as a second mortgage loan at a higher interest than the first mortgage loan. The second mortgage loan has to be amortised as this is the uncertain part of the loan. The remaining 10% of the purchase price is to be paid by the buyer. It is not possible for the consumer to borrow extra money to renovate their home with a mortgage deed as security, since the property can never be mortgaged to 100%. If the customer wishes to borrow money to be used for these causes, he or she has to take up a traditional consumer credit.

5 ANALYSIS

In this chapter we will analyse the findings from the interviews using the framework of this thesis as the base for the argumentation. Both positive and negative aspects are taken into account when analysing, this is done in order to stay as objective as possible.

5.1 The competition on the market for home loans

The banks we have interviewed have no problem in agreeing that the amount of money lent for house loans has increased over the past few years, as has the competition on the market for home loans. The home loans are described as a low margin product by all the banks participating in our study. Even so, many actors on the financial market are competing daily to win over mortgage loan customers from other banks. This is due to a lot of people having all their financial matters in the same bank where they have their mortgage, so by gaining mortgage loan customers the banks hope to also gain users of higher margin products and services offered by the banks.

According to our own experience, the younger generations of today are more used to comparing prices and different alternatives. The fact that a private person has always used one bank in the past, will not be reason enough to automatically choose this bank in the future. The topic of home loans is today a very well debated one, which can be considered to create a greater awareness among the public. When people are well-informed about the alternatives and the fact that terms and prices differ among different banks and mortgage credit institutions, the willingness to shop around for the best offer might be greater. There are customers who compare the conditions for home loans at various banks and then try to negotiate with the banks in order to get a better deal.

As customer's of today are more aware of differences amongst banks it is interesting to see how banks look upon their own competitive situation and how they choose to work with it, in order to strengthen it. Länsförsäkringar believes itself to be a bit worse off compared to the competitors, something that the bank explains by its margins being smaller than those of other banks. Nordea and Handelsbanken, on the other hand, seem to be rather comfortable with their market position. The increased competition could be said to be something positive from a consumer's point of view as it has led to lowered interest rates and better terms for the consumers. However, it can be discussed what impact the intense competition has on the banks' behaviour. How do the banks react when they see their market shares go down? Are the banks willing to take greater risks in order to protect their market shares? Perhaps a result would be that more people are granted loans, including people who might not really be able to take on the extra costs of a loan.

One way through which banks try to gain new clients is by advertisement. Many major banks are frequent buyers of advertisement space; something they hope will help strengthen their competitive situation. Both Länsförsäkringar and Nordea have TV commercials running right now with messages which they hope will attract customers. Handelsbanken, on the other hand, does not market itself by buying advertisement space, instead the bank hopes to live off its good reputation. According to regulations published by the Swedish Financial Supervisory Authority, the marketing of consumer credits should be neutral and moderate. It is a fact that banks are often seen advertising in media, whether or not their advertisement is to be considered moderate and neutral can be discussed. Does the advertisement change along with the increased competition? The increasing advertisement made by banks and credit mortgage

institutions might give rise to a new debate concerning whether or not the banks and the credit mortgage institutions are trying to mislead the consumers or not.

5.1.2 The credit mortgage institutions on the market

None of the banks interviewed see the credit mortgage institutions emerging on the market as a great threat. This can be considered to be rather natural, mainly due to the fact that the new actors, who are not as interested in the client's past, primarily focus on the customers that are not very attractive for the banks. The credit mortgage institutions are working with different conditions compared to the banks; both regarding the customers' payment history and to some extent the interest rates, which in some cases are higher. It could be said, however, that since at least one of the mortgage credit institutions is competing with the same interest rates as the banks on the market¹⁹, it is reasonable to believe that the credit mortgage institutions will be larger competitors to the banks in the future. When the consumers get more used to the new actors, a potential customer might not hesitate to place their home loan in a mortgage credit institution, if they offer the same or better terms as the banks.

Considering the relation between the bank's lending and the rising property prices it can clearly be a risk with these new actors contributing to the amount of capital available on the market for home loans, enabling the property prices to rise even more. At the same time, consumers who are not granted loans from the banks due to for example having a bad record of payment might be tempted to borrow money from one of the credit mortgage institutions, leading to a person who was already vulnerable before the loan becoming even more exposed to economic risks after having been granted the loan.

5.2 The impact of rules and regulations

The rules and regulations in the banking sector are more to be seen as a framework than as specific regulation. It would be impossible to regulate each circumstance in its every detail concerning financial matters. This means that quite a lot is left for the actors on the financial market to interpret when it comes to the details of the agreements.

When speaking about regulations in our interviews, the banks say, of course, that they comply with the rules. They believe the law of consumer credit, the European Agreement on a voluntary Code of conduct on pre-contractual information for home loans and other current regulations in the area to be something good. Our impression is that the banks generally do play by the book but that there is room for their own interpretations.

5.2.1 Basel II

Some attempts have been made to make the regulation more international, an example of this is Basel II. When it got adopted by the European Union, the aim was to make the European regulations on the financial market more standardised. The banks that we spoke to found the international regulation to be a good thing as it means that all banks working within the EU have the same grounds for competition. Also, as financial transactions across borders are becoming more and more common the security for the consumer is ensured through joint regulation.

The new regulations seem to have made different impacts on the way that the different Swedish banks act. All three banks participating in our study are in different stages of implementing the new rules. Handelsbanken said that the rating of customers was nothing

¹⁹ The interest rates of the actors on the Swedish home loan market are shown in appendix 3.

new as the bank had, for a long time, worked with individual interest rates depending on the financial abilities of the client. Länsförsäkringar said that the bank had started the work of rating the customers individually, which in a way might affect the bank's lending conditions towards the customers in the future. The two banks that have started the process of working with the new standard see new opportunities following from it. Nordea on the other hand, has not yet made any changes due to the new Basel II regulations. At Nordea, the new regulations are believed to perhaps have as an effect for the bank to be allowed to lend more money in the future.

5.2.2 Internal regulation

When carrying out our interviews it became clear to us that there is a need for a comprehensive internal regulation at the banks since the external regulations facing them leaves such a large room for interpretations. Some examples given to us by the banks as to how their internal regulation has affected their work were; in the case of Nordea, Gunilla Andersson said that the internal regulation has become stricter during the last couple of years. An example of this was that the bank increased the interest rate which is used when calculating the cost of loans from 5% to 8%. This is partly believed to be a way for the bank to reduce the increased lending that has been made possible by the low interest rates during the last couple of years and by reducing the lending the bank seeks to reduce its risk taking. As for Länsförsäkringar part of the internal regulation functions as a way for the board of directors to monitor the company and its employees to make sure that they follow the rules of the company. Both banks believe their internal regulation to be quite strict compared to their competitors. At Handelsbanken an important function of the internal regulation is to make sure that a certain repay ratio is being maintained, in order for the bank employees to be allowed to grant new home loans.

As the examples given to us by the banks ranged from such different areas as what interest rate to use when calculating the estimated costs of a loan to how the board of directors use internal regulation to keep track of the actions of their employees it was clear how important the internal regulation is for the banks. The laws which banks have to act in accordance with are rather vague and therefore it is very important for the banks to create their own guidelines as to what constitutes good behaviour when lending money and counselling clients.

5.2.3 Alternative to regulation?

When looking at how the prices are rising on the property market and drawing the conclusion that the rise in prices is due to the increased lending by banks the question arises whether the financial market should be regulated in a way that would stagnate the price escalation. Is there an alternative to the regulation of today? Could the amount of money lent be regulated by the government? Is it an option to regulate the sector more strictly and more precisely? Should there be stricter demands placed on the borrower?

These questions can be the starting point of an interesting discussion. Stricter regulation might be a way to better monitor the market for home loans and maybe it is even a way to prevent the prices of housing from rising, but at the same time it would be a large step back from the free market powers to a more centrally run society.

5.3 The requirements to be granted a loan

When it comes to what requirements banks have in terms of who gets to borrow money and who does not, it was not all that different from bank to bank. The banks calculate with an

interest rate of 6.5% - 8 %, they do not ask for a reserve for unexpected events and the living cost estimation for a couple was around 11 000-12 000 SEK at all banks. As all banks act this way, is it the right way to go about this issue? Is the bank responsible for who gets a loan or is it the consumer's own responsibility to make sure that he/she can handle the loan?

First of all, as for calculating with an interest rate higher than the one of today we do not find this to be much of a topic for discussion. It lies in the best interest of both the bank and the consumer that a kind of reserve is calculated, to make sure that when the client is buying a home, he or she will not be as vulnerable as to not afford the loans should the interest rate vary slightly.

5.3.1 Is it right for the banks to not demand of the consumers to have a reserve for unexpected events?

It can appear a bit odd for the banks to agree to the borrower getting a loan despite him or her not having any savings to be used should something unexpected happen. If you buy a house and you pay 10% of the purchase on your own there is often not that much money left. What happens when the heating system breaks down? Or when the car breaks down and needs to be repaired? Without savings this can cause serious problems for the borrower and it should be made clear to the borrower, by the bank, that having a reserve is not such a bad idea. Handelsbanken was the only bank that we spoke to which said that it wanted to see that the consumer has the ability to save money each month even after having bought the house or the apartment, to make sure that they can save up for a new reserve after having used their savings on the down payment, the mortgage deed and the entry into the land register.

It can be discussed whether it is good or bad that the banks do not have stronger demands on this point. One unexpected expense and the consumer might have problems paying his or her bills, causing unnecessary stress for the person. However, one explanation for this might be that the bank, should the consumer not have a reserve, could get to lend more money to the consumer should something unexpected happen making the client need more money. That second loan might be given as a consumption credit which means it would be given at a higher interest, which in turn means that the bank would earn more money on that loan than on the house loan, looking at the bank's margin. Therefore, it might be said that it is not entirely in the interest of the bank to make sure that the client has a reserve, as long as the client has the ability to pay the interest of an additional loan.

5.3.2 The calculation of living expenses – are the figures adequate? What about the interest calculated?

Even though banks are obligated by law to do a calculation of living expenses there are no definitive figures given to the banks that they should use. This means that banks have a certain amount of freedom when it comes to deciding what figures to use. Whether or not the numbers in the calculation are right or wrong is hence difficult to say.

As the numbers for the estimated living expenses are given by the Swedish Consumer Agency it feels like there has to be some substance to what they say. However, the numbers are generalisations which mean that some people will use up more and some will use up less. The society of today is consumption-oriented, we do not wait for things to break down or for clothes to get holes, we buy new things when we are bored with the old and look for renewal. This is a costly way of life.

For example, in the calculation the banks calculate with less than 1000 SEK for clothes per month and per couple. When thinking about what you can buy for 1000 SEK today and then considering that this is the budget for two persons it might seem like a figure that is set a bit low. For a young person, 1000 SEK is a pair of jeans for one of the two and then that month's budget has been used. With this said we do not mean that a young couple would be unable to live according to the budget used by the banks, it is just a question of discipline. However, maybe it would be a good idea for the banks, in the case of the consumers who barely pass the calculation of estimated living expenses, to let these clients keep track of their expenses during a month in order to get them aware of what they actually spend money on each month. This way these clients would get a better understanding as to what sacrifices have to be made after the loan has been granted.

5.3.3 Is it the bank's or the private person's responsibility to decide how much money to be spent on housing and whether or not the borrower can afford the loan?

Today, the prices on the housing market in Gothenburg are very high. This means that a lot of money might need to be lent for the purchase to be followed through. Who is then responsible if something should go wrong? It can be thoroughly discussed who is to blame when it comes to giving or taking a loan. There are arguments for both the bank and the private person to be held responsible.

People showing up at the bank have different levels of knowledge concerning having loans and owning houses. They need to be made aware, by the bank employee, of the consequences of their actions, should they take the loan. As people being granted loans are 18 years old or more they can all be held responsible for their own actions and it should be in their own interest to collect information about the different options and the risk that a loan represents. They should not afterwards blame someone else for making them sign a loan; they are after all the ones holding the pen.

At the same time, going to the bank is kind of like going to the doctor; you believe what they say to be true as you are in no position to argue since your knowledge in the matter is limited. When going to the bank the consumer meets someone who works with loans every day so it is not so strange for the consumer to believe in what that person tells him/her. However, even though it feels like going to the doctor, it is not. When at a bank it is actually possible to have collected enough information in advance in order to be able to have a dialogue with the bank employee and to really be made aware of the consequences of a loan, at least to a certain extent. There is, however, an information asymmetry between the lender and the borrower and the borrower is the one who has the least knowledge and information. It is therefore up to the bank to thoroughly discuss the impacts of a loan so that the consumer is made aware of what might happen when indebted. It is important to remember that banks are not guardians taking care of the consumers and there is nothing in the regulations telling them to be. Banks are profit seeking companies who merely offer a service enabling people to buy what they could not afford otherwise. They are not looking to do the consumers a favour; they are looking to make money.

So, both the bank and the consumer have responsibilities; collecting and handing out information. The consumer should collect enough information as to feel like he/she knows what the impacts of the loan will be regarding his/her private economy. It is important to know what the sacrifices will be and to feel like they are worth it. As for the bank, it can be considered responsible to clarify to the consumer what the consequences of taking a loan are

as well as stating that there might be unexpected events in the future of which the consumer should be aware and have a back-up for.

5.4 The valuation of securities

What is important to understand concerning the bank's valuation of securities is the fact that the bank's main focus is on whether or not the private person can afford the costs of the loan, not on whether or not the value assigned to the security is the correct one, as the security behind the loan is not supposed to have to be used. In order to avoid for the security to actually be used to pay the loan, the decision as to whether or not the private person is granted a loan is the main decision and it is not based on the value of the security but on the borrower's ability to pay for the interests and the additional costs of the loan. This type of reasoning was especially expressed at Länsförsäkringar and Nordea. The one bank that did seem to care a bit more about the valuation of the security was Handelsbanken. They stressed the importance of having a security that would be able to cover the loan should something happen to the borrower's ability to pay. This was also the reason for which Handelsbanken did not accept the first mortgage loan to be higher than 75% of the estimated market value, as they wanted to have a margin if forced to sell the house or apartment on behalf of the customer.

If the borrower can pay the interests and the other costs of the loan, the value of the security is a minor issue. Banks do not make much effort to really decide if the value of the security is a rightful one. The price decided through supply and demand on the market is in most cases seen as the correct value. Only if large deviations are found between the purchase price of the particular object and the computer simulation made by the bank, comparing the purchase price of the object with the purchase price of other properties in the area, will the bank hire a real estate valuer to estimate a rightful value.

This makes it clear that the banks do not slow down the price increase. A situation where one object in a certain area has been approved a high value, will lead to more houses or apartments in the same area being estimated to have the same high value. If the market is overheated and the high prices lack substance, this might be dangerous. On the other hand, it can be argued that the market price is the correct value and if there is a buyer willing to pay the price; this might justify the high value. However, the buyer needs capital in order to have the ability to pay for the house/apartment. The providers of the capital are the lenders on the market, the banks. As mentioned earlier the banks focus is on whether or not the borrower can afford the expenses of the loan, not if the value of the security is the correct value. If the banks believe that the private person can afford the loan, they will be more than happy to lend the money as lending is a way for the banks to make a profit.

At some banks today, private persons have the option to borrow towards the total price of the object. 90 percent in a first mortgage loan, and the last 10 percent at a higher interest. Of course, this is a way for the banks to increase their profit. Again if the borrower can pay the costs of the loan there is a lender willing to supply the money needed. If a private person is willing to pay a high price for his/her place to live, should the bank then deny that person a loan? The question which can be asked is: should the banks act in a way that would slow down the price increase? In one way they have the power to do this by not providing the buyers with money. On the other hand, is this really their assignment? Banks are profit making organisations as all other companies in different business areas. If they see the chance of making money, what says that they should not be free to lend the capital demanded?

6 Conclusions and suggestions for further research

In this chapter the conclusions drawn from the analysis are presented by answering the questions posed in the problem definition. In the end of the chapter suggestions for further research is given.

6.1 Conclusions

Since 2001, the average price paid for a house in Sweden has been above the assessed value of the property. Despite having passed that point, prices do not seem to cool down. When starting to write this thesis we wanted an answer to what role banks play concerning the elevated prices on the private property market in the Gothenburg region. In order to find information on this we posed some additional questions that would shed some light on the whole area.

First, we needed to get more information as to what rules banks have to play by. When doing this, we found that the laws applicable to the house loan market are very unspecific. They function mainly as a framework, leaving banks an opportunity to decide their own rules as long as they stay within certain boundaries. As the rules facing banks are so loose there is no reason for banks to look aside from laws and external regulations facing them as these do not really state for the bank to do this or that. However, what is more interesting to think about is the banks' internal regulations which can be adjusted to allow for a borrower to be granted a loan even though he/she might not really fit the model. If the client applying for the loan is a client desired by the bank then the bank can look past the internal regulation and grant the client the loan. Banks do, however, try to avoid credit losses as they are responsible towards their share holders and the people with savings in the bank. On the other hand, in good times banks might take larger risks as they are better capable of handling credit losses. If the consumer pays the interests as planned everything is ok, if he/she does not then the bank can afford the loss.

Second, we needed to get more knowledge concerning the criteria to be fulfilled by the consumer in order for a bank to grant the consumer a loan. We found that the banks that we spoke to had pretty similar demands on the consumers. They had different ways of calculating the estimated living expenses, but in the end the results were almost the same. Banks are obliged to check the solvency of the consumer and to calculate that the consumer will afford to live even with the additional costs of the loan. However, what numbers are used by the banks when calculating this is free for the banks to decide themselves. There are guidelines made available by the Swedish Consumer Agency but it can be discussed how well these figures meet reality. Banks have to carefully evaluate every loan they grant though. Partly with the interest of the person borrowing, but first and foremost, so that the bank does not jeopardise its financial stability. If the banks were to take too great credit risks, they could lose their savers' deposited money and risk not to fulfil their obligations towards their shareholders.

Third, what interested us when it came to the real estate market was how banks value the securities left for the loans, in most cases the mortgage deeds. We found out through our interviews that the important thing for the bank is not whether or not the purchase price of the house is the correct value but rather that the buyer can afford to pay the interests on the loan. As the security is not supposed to be used some banks see its value as less important. If the

client can pay for the loan, the bank will lend the money. This makes it clear that the banks are not acting as brakes for the price development of today.

Our last additional question was whether or not banks can be assigned some kind of social responsibility as they are the ones making capital available on the market. Even though it might sound like a good idea to somehow force the banks to cut the lending in order for the rising prices on houses to cool down it is not the ideal situation for this to be regulated by law. Banks are profit making companies like all other companies and we live in a free market economy where the prices are decided by supply and demand. Why should banks want to cut their lending as long as there is a demand for their money? And as long as there is a supply of money, affordable to the consumer, why should people not want to buy a house which the bank says they can afford, just to stop the prices from rising? And why should the seller of a house not want to get as much out of the house as possible when selling?

Finally, let's take another look at our main question: what role do banks play concerning the elevated prices on the private property market in the Gothenburg region? Well, the capital made available by banks is what enables prices on houses to rise, but the prices are also rising due to the economy in general being favourable. People are willing to spend a larger amount of their disposable income on their housing today. Over the past few years Sweden has experienced an economic upswing, which has led to there being more capital available on the market. As there has been a larger supply of capital, the interest rates have been low which has made it very advantageous to borrow money. People have, due to the low interests and the boom in the business cycle which we are now experiencing, been able to afford to take larger loans in order to pay higher prices for their housing. Another reason for it being advantageous to borrow money is the increased competition between the banks, which has led to a very aggressive approach in order to win customers; resulting in large loans at low interest and basically no demands for amortization. The fact that people can rather easily borrow money leads to them being able to pay more for their housing which leads to prices rising. As long as banks keep lending money at a low interest, they allow for prices on housing to rise.

We find it to be important to stress that consumers need to be aware of the possible risks of taking a loan and how the loan will affect their private economy. Consumers should not take what the banks say as a universal truth; it is dangerous to get too blinded by the desired object as to not see the consequences of the loan. Even if the bank says you can afford it, you might not find the sacrifices worth it in the end.

6.2 Suggestions for further research

As for suggestions for further research we would find it interesting to look into the matter of advertising on the market for consumer credits. It can easily be established that some banks put a lot of effort into marketing themselves. Does the advertisement change along with the increased competition? Do the marketing agree with the demand of current regulation for the banks' marketing to be neutral and moderate?

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Appendix 1

Interview manual

The development on the home loan market over the last couple of years

- Has there been an increased lending over the last couple of years? If yes, what are believed to be the reasons behind this increase?
- Has the increased competition on the market for home loans affected the bank's terms for lending?

The rules and regulations facing banks and how they affect the granting of loans

- How does the bank look upon the current regulations in the banking sector?
- Does the bank find the regulations to be specific or does it leave room for the bank's own interpretation?
- What regulations does the bank consider to be the most important? International, national, internal etc.
- Has the implementation of Basel II affected the lending to private persons?

The requirements to be granted a loan

- What values are used in the calculation of living expenses?
- How large must the difference be between the disposable income and the estimated cost of the loan?
- Does the borrower need to have a reserve for unexpected events? If so, how large does it have to be?
- How high is the interest calculated in the calculation of living expenses?

The valuation of securities

- How is the valuation of the object carried out?
- Does the bank turn to external valuers?

Appendix 2

The general terms of the European Agreement on a voluntary Code of conduct on pre-contractual information for home loans are listed below:

General Information to be provided to the consumer:

Initial information about home loans should include or be accompanied by the following information in the same format as that initial information is itself provided:

A – Lender:

1. Identification and address of the lender;
2. Where appropriate, identification and address of the intermediary.

B - Home Loan:

1. Purposes for which the home loan may be used;
2. Form of surety;
3. Description of the types of home loans available with short description of the differences between fixed and variable rate products, including related implications for the consumer;
4. Types of interest rate – fixed, variable, and combinations thereof;
5. An indication of the cost of a typical home loan for the consumer;
6. A list of related cost elements, such as, administrative costs, insurance costs, legal costs, intermediaries costs...;
7. The different options available for reimbursing the credit to the lender (including the number, frequency, amount of repayment instalments if any);
8. Whether there is a possibility of early repayment (if so, its conditions);
9. Whether a valuation of the property is necessary and, if so, by whom it has to be carried out;
10. General information on tax relief on home loan interest or other public subsidies prevailing, or information on where one can obtain further advice;
11. The duration of the reflection period, where relevant;
12. Confirmation that the institution subscribes to the Code, and indication that a copy of the Code is available in the institution.

(www.ec.europa.eu)

Appendix 3

The actors on the Swedish market for home loans

Banks:



Credit mortgage institutions:

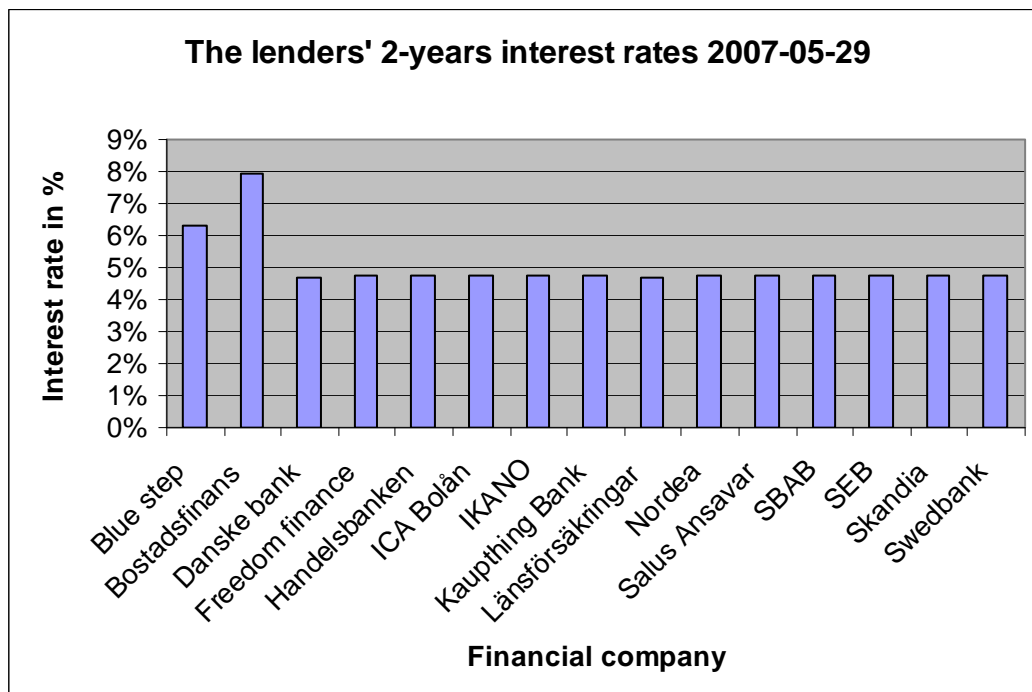


Figure 6, The lenders 2-year interest rates 2007-05-29

Information gathered from the financial institutions' web-sites 2007-05-29. The interest of Blue step is only available for a 3-year period and the interest of Bostadsfinans is always fixed.

Appendix 4

The Swedish Consumer Agency's calculation of household costs

Women

Individual budget posts SEK/month	Women			
	18-30 years	31-60 years	61-74 years	75 years-
Groceries, except weekday lunches	1 110	1 080	1 000	980
Groceries, all meals taken at home	1 440	1 400	1 300	1 260
	18-30 år	31-49 år	50-60 år	61 år-
Clothes and shoes	500	500	500	460
Sparetime and play (incl. mobile)	470	470	470	470
Hygiene	310	310	290	290
Sum, without groceries	1 280	1 280	1 260	1 260

Men

Individual budget posts SEK/month	Men			
	18-30 år	31-60 år	61-74 år	75 år-
Groceries, except weekday lunches	1 450	1 380	1 250	1 100
Groceries, all meals taken at home	1 870	1 770	1 610	1 400
	18-30 år	31-49 år	50-60 år	61 år-
Clothes and shoes	490	490	490	490
Sparetime and play (incl. mobile)	470	470	470	470
Hygiene	240	240	240	240
Sum, without groceries	1 200	1 200	1 200	1 200

Common household costs

Household specific budget posts SEK/month	1 person	2 persons	3 persons	4 persons	5 persons	6 persons	7 persons
Consumables	100	120	200	240	290	340	380
Home equipment incl. computer	520	610	730	800	930	1 070	1 140
Media, telephone, Internet etc	750	780	820	830	850	870	890
Home insurance							
Big city	150	160	170	180	190	200	220
Average city	100	110	120	120	130	130	150
Small city	80	80	90	90	100	100	110
Sum							
Big city	1 520	1 670	1 920	2 050	2 260	2 470	2 630
Average city	1 470	1 620	1 870	1 990	2 200	2 400	2 560
Small city	1 450	1 590	1 840	1 960	2 170	2 370	2 520
Use of electricity household/month	150 kWh	220 kWh	270 kWh	310 kWh	330 kWh	350 kWh	360 kWh

(www.konsumentverket.se, 3)