Contribution to blog on The Danish mortgage system.

In the wake of the financial crisis regulators and politicians look for financial systems that withstood the financial storm in 2008 and 2009. The Danish Mortgage system is such a system. It is transparent and stable and has contributed to financial stability in Denmark the past 200 years. The system has existed since 1795, and no mortgage bank has ever gone bankrupt. All mortgage loan are match funded i.e. there is a 1:1 relationship between the loans granted and the covered bonds issued to fund the loans. Danish mortgage banks use covered bonds as the only funding tool – no deposits or other types of funding are used. Additionally borrowers' interest rates are set by supply and demand in the bond markets and are passed-through to investors in a 1:1 relation. Since the interest rates are market based it is crucial, that the bonds funding the loans can be traded anytime. Even during the peak of the financial crisis Danish covered bonds was actively bought and sold in the financial markets. (learn more about how the Danish mortgage banks handled the crisis: El Modelo Hipotecario Danés).

Interest rates on Danish mortgage based housing loans are independent of borrowers' income or wealth. Put differently a wealthy family pays exactly the same mortgage interest rate on a housing loan as a middle income family. It is due to the fact that mortgage interest rates are determined by supply and demand on the covered bond markets – interest rates are not based on credit and wealth assessments. The equality element in the Danish system makes sure that 49,5 per cent of all families in Denmark live in owner-occupied housing with a mortgage loan (in Spain it is 32 pct. according to Eurostat). Moreover, the easier access to low interest rates makes it much easier for young families to leave their parents and settle in a new place. In Denmark less than 20 per cent of adults aged 18-34 live with their parents. In Spain it is more than half of adults aged 18-34 who live with their parents.

Danish mortgage banks also provide a lot of funding to Danish corporations and SMEs based on the same principle of market based interest rates. The mortgage banks require a company specific fee paid on top of the interest rate – typically in the range of 0,5-1,1 per cent. Both home-owners and companies pay low interest rates that are on average 2,4 per cent and 2,1 per cent respectively, if you include the fees paid both by home-owner and companies. The rates reflect that the interest rate are fixed for 30 years on 41 per cent of all outstanding loans to home-owners.

Since Danish mortgage banks keep all mortgage loans on their balances, mortgage banks make sure that the credit assessments are done thoroughly. Consequently the number of arrears and foreclosures are kept at a minimal level. On top of that when a loan is granted, borrowers are by law obligated to be able to pay interest rates and repayments on the most expensive loan on the market. So even if people choose interest only loans or loans with adjustable rates they would have an income cushion to withstand interest rates hikes. In a similar way the Danish mortgage system works as a cushion to financial chocks – ultimately contributing to a more stable economic development (Read more about the stabilizing effect from the Danish mortgage system in "Financial structure and the real effects of credit-supply shocks in Demark 1922-2011", Danmarks Nationalbank, Working papers 2012)

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