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Housing Finance Legislation in Selected OECD Countries

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HOUSING FINANCE LEGISLATION IN SELECTED OECD COUNTRIES

COMPARATIVE SUMMARY

Executive Summary

This overview briefly summarizes the attached country reports respecting housing finance legislation in Canada, England and Wales, France, Germany, Italy, and Japan.

I. Foreclosure Laws

In the two common law countries of Canada and England and Wales, a mortgagee generally has two basic options in deciding how to proceed against a mortgagor who is in default. The first of these is to apply to a court for an order of foreclosure. If granted, the lender takes title and possession of the property in question and has no right to seek any deficiency. Since the foreclosure process is judicially supervised, rules have been developed to protect debtors, as for example, allowing the debtor to request that the property be sold if its market value is greater than the amount due on the mortgage. Foreclosure is a relatively expensive and time-consuming process and, for these reasons, mortgagees generally prefer to sell the property in question rather than to foreclose on it. In some Canadian provinces, this can only be done under the supervision of a court. However, in England and Wales and the four Canadian provinces of Newfoundland, New Brunswick, Prince Edward Island, and Ontario, powers of sale can also be employed. These powers of sale can be statutory or contractual rights and are generally exercisable if the mortgagor is in default for at least three months. The mortgagor is usually given a redemption period and sales must be conducted in accordance with rules designed to protect their interests. However, when a mortgaged property is sold by a lender, the mortgagor remains liable for a deficiency.

It appears that sales of mortgaged properties in default can usually be effected within six months in Canada's power of sale provinces. In England and Wales, the governing statute gives debtors greater rights of appeal that can extend this period. However, other European countries appear to make foreclosures significantly more difficult and time-consuming. The relevant French law extends back to the Napoleonic Civil Code of 1804, but is now found in a consolidated ordinance and decree from 2006. Under the relevant French law, a creditor has to first obtain a judgment against a debtor before a forced sale can start. After several preliminary steps are taken, a debtor is called to appear at an orientation hearing. At the orientation hearing, the judge hearing the case decides whether to accept an amicable sale or order a forced sale. However, orders for a forced sale are appealable and debtors can ask that their property be re-auctioned if anyone is prepared to pay at least ten percent more than was obtained at the first auction of the property.

The German framework dates back to the end of the nineteenth century, but has been amended a number of times to give creditors greater rights to raise various defenses and objections. The relevant German law also provides that a debtor cannot seize encumbered property, but must apply for a forced auction under the supervision of a court. However, in Germany, even the process of auctioning off a property does not necessarily end with the former owner being ordered to leave the property. A provision of Germany's Code of Civil Procedure allows a court to set aside permanently or temporarily a measure of execution if it would create a hardship that would violate German public policy. The courts will grant this relief when the coercive execution measure would cause serious harm to the physical or mental health of the affected person, create a potential for suicide, or make families with small children homeless. If relief is granted, the new owner may find himself in the position of being a court-appointed landlord.

In 2008, Germany enacted a Risk Limitation Act to give borrowers even greater protections. This law requires lenders to give borrowers six-months notice before they can petition for foreclosure and provides that proceedings can only be commenced if the debtors is in arrears for an amount equal to 2.5 percent of the face value of the loan.

In Italy, foreclosure has been provided for since the Civil Code was enacted in 1942, but the process is "long and costly." It has been reported that foreclosure on a residential property can take five to seven years from the time a borrower goes into default.

Japan enacted its first modern foreclosure law in 1898, but foreclosure is now provided for in the Civil Code and an Execution Law originally enacted in 1979. These laws have been amended several times to make procedures more flexible and faster. In 2006, 24.2 percent of civil executions took less than six months, 54.1 took between six months and a year, and 5.4 percent took more than two years. This appears to put the length of time a foreclosure takes in Japan in the middle of the countries surveyed.

Foreclosure in Japan generally requires court supervision, but creditors and debtors can agree that one of them will sell the property on the open market. If the courts order an auction, the base price is eighty percent or more of its estimated value. The courts can also order preview opportunities for potential buyers.

II. Tax Treatment of Owner-Occupied Housing

Italy and France are the only surveyed countries that allow a deduction or give a tax credit on account of interest paid on mortgages in calculating personal income that is subject to income tax. Italy offers a tax credit of up to 19 percent for mortgage interest and other home ownership expenses, subject to strict limits. For example, there is a limit of €4,000[1] on the credit for interest on mortgages of owner-occupied housing. Italy also offers a tax credit of thirty-six percent of the cost of refurbishing real estate, up to a limit of €36,000.

[1] Current conversion rates are indicated in the individual country reports.

France gives a tax credit for interest on loans taken out since August 22, 2007, for the purchase of a person's main residence if the home meets specific thermal and energy standards. The qualifying loan interest deduction is generally limited to €3,500 for a single person and €7,500 for a couple, but is increased by €500 for each dependent. The qualifying interest for handicapped, widowed, or divorced persons living alone is €7,500. France also offers a tax credit for energy-saving systems or equipment bought between 2005 and 2012. Depending upon the date the expenses were incurred the tax credit is equal to between twenty-five and sixty percent of those qualified expenses, but there is a cap of €8,000 on individuals and €16,000 on couples. The cap is raised by €400 for each dependent.

Japan allows persons to deduct a portion of their loan in calculating their income tax due. Under a 2009 bill, a person can deduct up to one percent of their loan up to fifty million yen spent on a house from his or her annual income. The amount of the deduction will decline every year for persons who buy a house in 2011, 2012, or 2013. For persons who bought homes prior to 2009, a deduction of one percent of up to 30 million yen can be deducted every year for six years. Half of this amount can be deducted from the seventh to tenth year of ownership, up to a limit of twenty million yen. A person can also elect to take a smaller deduction over fifteen years of 0.6 of the amount of a loan of up to twenty million yen for the first ten years and 0.4 percent of the loan for the following five year.

In England and Wales tax relief for mortgage interest was created in 1983 and ended in 2000. While it existed, the mortgage interest deduction was on loans of up to £30,000. Home owners could deduct the amount of relief they were entitled to in making mortgage payments. Lenders were then reimbursed by the Inland Revenue authorities. This system was abolished to save administrative costs.

Germany granted deductions for home mortgage payments until 1996, when they were abolished in favor of cash grants to lower- and middle-class home owners. Since 2006, these cash grants of up to a maximum of €1,250 are being phased out. However, there are still some opportunities for subsidies on building savings contracts.

Canada recently created a Can$750 tax credit for first-time home buyers. The government has also set aside Can$1 billion to encourage individuals to install energy-saving retrofits and energy efficiency upgrades.

While all of the countries surveyed deny or severely limit deductions on account of mortgage interest paid, they do have principal residence exemptions from capital gains tax. In Canada, persons are only limited to claiming one principal residence per year. In France, the period for disposing of a home without attracting capital gains tax is being increased from one year, as in Canada, to two years due to current market conditions. In Japan, capital gains are exempt on owner-occupied housing up to 30 million yen. Capital gains on homes owned for more than ten years is ten percent on the first 6 million yen above the excluded amount and fifteen percent for any amount above that. Germany and Italy not only generally exempt the sale of primary residences from capital gains tax, but also have exemptions from capital gains tax for inherited residences.

III. Housing Agencies

Canada's national housing agency is the Canada Mortgage and Housing Corporation. This agency guarantees qualified home mortgages if the mortgagor makes a down payment of at least five percent of the purchase price.

England and Wales do not have a national housing agency. England and Wales do have a government-operated Support for Mortgage Interest Program for persons receiving income support or certain allowances.

France's *Crédit Foncier de France* was originally created in 1852 as a public financial institution, but was privatized in 1999. The *Crédit Foncier* has remained a top mortgage specialist bank. France has a mandatory contribution law that requires employers to contribute 0.45 percent of all salaries to a housing fund. France's *Caisse des Dépôts et Consignations* is a public financial institution that centralizes and manages savings deposits of a number of banks**.**

Germany does not have national housing finance agencies. Germany appears to regulate the field through tight supervision of its banks.

The Italian government plays a small role in housing financing. In 2005, it subsidized interest rate payments for less than two percent of home mortgages.

In Japan, the Japan Housing Finance Agency replaced the Government Housing Loan Corporation in 2007. The new agency does not provide loans directly to households, but does back loans from other banks. Japan also has a program that allows workers to set a portion of their salary aside to purchase a home. Interest earned by a contributor is exempt from income tax.

IV. Concluding Remarks

Housing Finance Legislation differs from country to country. Foreclosure laws are particularly complex and often difficult to compare, though France, Germany, and Italy stand out for having processes that are usually time consuming. Canada, England and Wales, and Japan have laws that allow for quicker foreclosures or sales of homes covered by mortgages that are in default.

The tax laws of the surveyed countries show many similarities. All of these countries disallow or greatly limit deductions of mortgage interest. On the other hand, exemptions from capital gains tax on residential properties are common.

Government involvement in housing finance is generally limited. Not all countries have national governmental agencies to guarantee mortgage loans. Canada and Japan are two exceptions in this regard.

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CANADA

HOUSING FINANCE LEGISLATION

Executive Summary

In certain Canadian provinces, lenders can sell homes covered by a mortgage that is in default in less than six months without the involvement of the courts. In the other provinces, lenders must conduct judicial sales and that process can take up to two years. In all provinces, lenders can take possession of a property covered by a mortgage that is in default through foreclosure. The length of that process is generally longer than a non-judicial sale, but less than a judicial sale.

Tax law does not allow tax deductions for mortgage interest. However, it does have a principal residence exemption from capital gains tax and allows persons to withdraw up to Can$25,000[1] *from their Registered Retirement Savings Plans to purchase a home for the first time. These withdrawals must be repaid over fifteen years to avoid being taxed as income.*

Canada's national housing agency is the Canada Mortgage and Housing Corporation. This corporation guarantees residential home loans if the purchaser makes a down payment of five percent of the purchase price. The Canada Mortgage and Housing Corporation also administers a number of other programs designed to promote energy efficiency and to assist low-income individuals, aboriginals, and disabled persons.

I. Foreclosure Legislation

In Canada, a lender generally has two options when a borrower defaults on a mortgage. These two options are to either sell the property or take possession of it through foreclosure. In both cases, an action by a lender against a borrower who is in default on his or her mortgage is governed by provincial legislation. The federal government does not have jurisdiction to enact uniform legislation for the entire country.

The relevant laws of Canada's ten provinces can be broken down into two categories respecting sales of properties that are subject to a mortgage in default. The first category is where the sale of a property must be approved and supervised by a provincial court. This "judicial sale" method is primarily used in Alberta, British Columbia, Nova Scotia,

[1] 1 Canadian dollar = 0.786302 U.S. dollars as of March 17, 2009.

Saskatchewan, Manitoba, and Quebec.[2] The other category is where the lender has a right to sell the property without the involvement of the court either under the terms of the mortgage document or the applicable provincial law. This "power of sale" method is primarily used in Newfoundland, New Brunswick, Prince Edward Island, and Ontario.[3] In these provinces, judicial sales are also sometimes available, but tend to be used less frequently because they are slower, more formal, and more costly. Power of sale provisions are generally of more recent origin, but some judicial sale provisions have evolved in recent years to give borrowers greater legal rights.

Aside from the extent of court involvement in the process, the two methods of selling properties differ in two other significant respects. In the power of sale provinces, the process of selling a property is initiated with notice to the borrower, whereas in the judicial sale provinces, the process begins with a lawsuit against the borrower for default. Also, in the power of sale provinces, a lender seeking a deficiency judgment must commence proceedings after the property has been sold, whereas in the judicial sale provinces, a deficiency judgment can be sought as part of the main action of suing the borrower. Deficiency judgments are a very significant aspect of real estate law in Canada because all of the provinces provide that lenders can seek damages from borrowers who default on their mortgages if they follow certain prescribed procedures. No province provides that a person who obtains a mortgage can default on it and be immune from any further action. The ability of lenders to seek deficiencies has been a disincentive to persons purchasing homes that they may not be able to afford. Along with stricter lending practices, it is one of the major reasons why Canada has not had a widespread nonconforming housing loan crisis in recent months, although foreclosures and sales by lenders of mortgaged homes are up fairly significantly due to deteriorating economic conditions, which are attributable more to sharp declines in exports and a rise in unemployment than a bursting of a "housing bubble."

Statistics on the rates of foreclosures and sales by lenders in Canada are generally difficult to obtain in most provinces. One national newspaper recently reported as follows:

> Foreclosure proceedings in Alberta have more than doubled in two years, according to data provided by the Alberta Justice Department—from 2,510 in 2006-2007 to 5,300 in the first eleven months of 2008-2009. According to statistics provided by the British Columbia government, the province has seen a similar surge, with nearly 2,100 foreclosures filed between April and December of 2008—more than the 1,900 that were filed in the entire previous year.[4]

Since Alberta and British Columbia are "judicial sale" provinces that have laws that generally give borrowers greater protection and rights than the "power of sale" provinces, figures for the largest "power of sale" province, Ontario, are thought to be significantly higher even

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[2] Foreclosures.ca, *Foreclosure Proceedings Across the Nation*, http://www.foreclosures.ca/realtors/foreclosure_proceedings/index.lasso (last visited Mar. 15, 2009).

[3] *Id*.

[4] Greg McArthur and Jacquie McNish, *Canada's Dirty Subprime Secret*, GLOBE AND MAIL (CANADA), Mar. 14, 2009, at A8.

though figures have not been released. Thus, the rise in foreclosures and sales by lenders throughout Canada is a national problem. The report cited above attributes much of this increase to a subprime lending problem that has not received much attention or exposure in Canada. In fact, Canadian banks and government officials have generally denied that Canada has any subprime mortgage crisis. While it does appear to be true that the regulation of lending practices and the practices of the five major banks in Canada that dominate the industry have resulted in a more stable housing sector in Canada than in the United States, there are lenders in Canada that have offered loans that were initially at less than market rates and lenders that have offered loans to persons who could not qualify at the country's large chartered banks. In British Columbia, this "tiny" subprime market is reported to have initiated 42 percent of the mortgage foreclosures in 2008.[5] While figures were only available for that province, it appears that the percentage in the other nine is probably fairly close.

Sales by lenders in Canada's most heavily populated province of Ontario are relatively quick because it is a "power of sale" province that has provisions that are relatively favorable to lenders in its Mortgages Act.[6] Power of sale was initially developed by lenders in the province who wanted a faster way to dispose of property and recover debt than through judicial sale, and it was incorporated in the governing Ontario legislation prior to it being consolidated in 1990. Under the Mortgages Act, a borrower is considered to be in default after failing to make payments on a mortgage for three months. Fifteen days after the borrower is in default, the lender can serve the borrower with notice of his or her intention to sell the property. Notice must also be given to anyone else having an interest in the property such as subsequent encumbrancers, statutory lien holders, and anyone who has given the lender written notice of an interest in the property in question. The form of the notice is called a Notice of Sale and it must include details such as when the mortgage was made, the parties to it, the amounts owing, and a warning that the property will be sold.[7]

Once a borrower receives a Notice of Sale, he or she has thirty-five days to make his or her past payments unless the mortgage agreement provides for a longer period. The thirty-five days are called the "redemption period." If the mortgage is not redeemed, the lender can sell the property by auction, private contract, or tender. It has been reported that most properties are listed with a real estate agent and placed on the market for sale.[8] Guidelines provide for multiple listings, obtaining appraisals, and a minimum listing period. Once a property is sold, the lender must account to the borrower for any surplus. However, the Mortgage Act provides that the proceeds of sale must be applied first to the cost of conducting the sale, secondly to the interest and costs owing under the mortgage, and thirdly to the principal money owing under the mortgage.

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[5] *Id*.

[6] Mortgages Act, R.S.O. ch. M.40 (1990), *as amended*, *available at* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90m40_e.htm (last visited Mar. 15, 2009).

[7] *Id*. §§ 24-32.

[8] Foreclosures.ca, *The Foreclosure Process in Ontario*, http://www.foreclosures.ca/realtors/foreclosure_proceedings/ontario.lasso (last visited Mar. 14, 2009).

Judicial sales are also possible in Ontario, but because the use of the power of sale is faster, it is used in over ninety percent of defaults in that province.[9]

Foreclosures are primarily used when the lender does not believe that he or she will be able to sell the property in question for an amount sufficient to cover the principal of the loan and the costs of sale, and will not be able to recover the deficiency from the borrower. Foreclosures are also used when the lender believes it would be advantageous for it to take possession of the property and make improvements before selling it. Two members of one of Canada's leading law firms have written an article in which they list the principal advantages of foreclosure actions as follows:

1. In foreclosure actions, proceedings are court supervised and the lender is protected from actions alleging a failure to comply with the power of sale rules.
2. The courts are available to resolve complex issues.
3. Claims can be combined.
4. Lenders are not exposed to liability to prior lenders.[10]

However, this same article points out that power of sale is preferred in the majority of cases because:

1. A power of sale process can generally be completed in approximately six months as opposed to the two years that a contested foreclosure can take.
2. It is much cheaper to exercise a power of sale.
3. A notice of sale can be commenced by registered mail instead of being personally served upon all defendants.
4. A lender retains the ability to sue the borrower and any guarantor for any shortfall.
5. Land transfer taxes are avoided.
6. Power of sale proceedings can be abandoned at any time.[11]

Of the above-listed advantages, the first seems to be the most significant. The ability of a lender to sell a mortgaged property in default in as short an amount of time as six months or less compares very favorably to other countries. However, power of sale is not available in all provinces or in all cases even in those provinces that allow it. Nevertheless, even in foreclosure cases, lenders can usually take possession of the property in less than two years. This still compares favorably to many other countries (see companion reports).

The other major advantage of exercising power of sale is that it preserves the lender's right to commence an action to receive any deficiency. If the lender forecloses on a mortgage, he or she obtains title to the property and cannot sue the borrower for an outstanding balance or deficiency.

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[9] Foreclosures.ca, *Foreclosure Proceedings Across the Nation*, *supra* note 2.

[10] Jim Hilton and Silvana D'Alimonte, *Canada: Selecting a Mortgage Enforcement Remedy*, MONDAQ.COM, Oct. 29, 2008, http://www.mondaq.com/article.asp?articleid=68826.

[11] *Id*.

II. Tax Treatment of Owner-Occupied Housing

Under Canada's income tax legislation, interest paid on a mortgage is not deductible in calculating taxable income. This is one of the most significant differences between the income tax laws of the United States and Canada.

Although interest on a mortgage is not deductible in Canada, tax incentives for home ownership do exist. The two primary incentives are the principal residence exemption and the ability of first-time homeowners to withdraw up to Can$20,000 from their Registered Retirement Savings Program (hereinafter referred to as a "RRSP") to purchase a home.

The principle residence exemption eliminates capital gains tax on the disposition of a taxpayer's principal residence, subject to certain exceptions. In order to qualify as a principal residence, the property must have been owned by the taxpayer. Joint ownership with another person qualifies for this purpose. The property also must have been inhabited by the taxpayer or by his or her spouse, common law partner, former spouse or common law partner, or child. A taxpayer can only designate one property as his or her principal residence for a particular year. If the property is located on land in excess of one-half acre, the excess land must be shown to be necessary for the use and enjoyment of the housing unit as a residence in order for the sale of that land to be exempt from tax.[12] Determinations as to whether the land is necessary for the use and enjoyment of the residence are made by Canada Revenue Agency officials and may be appealed. There are special rules for principal residences located on farms.[13]

A change in the use of a property from a principal residence to an income producing property or an income producing property to a principal residence generally results in a deemed disposition of that property. However, a taxpayer may elect to postpone capital gains tax for a period that is usually up to four years, but this period may be extended in the event that the taxpayer experienced work relocation.[14]

The rules respecting the principal residence exemption in Canada are explained more fully in an Income Tax Interpretation Bulletin issued by the Canada Revenue Agency.[15]

The other major tax incentive designed to encourage home ownership in Canada is the Home Buyers' Plan (hereinafter referred to as "the HBP"). For many years, Canada's RRSP program has been highly successful in encouraging savings for retirement. In fact, the RRSP program served as a model for the original Individual Retirement Account program in the United States. Until 1992, contributions to an RRSP could not be withdrawn before retirement without incurring income tax because they are tax deductible. In that year, however, the federal government announced that it would allow individuals to withdraw up to Can$20,000 of the

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[12] Income Tax Act, R.S.C. c. 1, § 40(2)(b) (5th Supp. 1989), *as amended*, *available at* http://laws.justice.gc.ca/en/showtdm/cs/I-3.3 (last visited Mar. 16, 2009).

[13] *Id*. § 40(2)(c).

[14] *Id*. § 40(2).

[15] Canada Revenue Agency, IT-120R6, *available at* http://www.cra-arc.gc.ca/E/pub/tp/it120r6/README.html(last visited Mar. 16, 2009).

funds in their RRSPs for the purpose of buying their first home. Since then, the HBP has been extended to allow withdrawals to purchase homes for disabled persons and persons who have not owned a home for at least four years.

The HBP allows an individual to withdraw a certain amount (originally, up to Can$20,000) on a tax free basis if the individual purchases a home by October 1 of the year following the year of withdrawal. However, the withdrawn amount must be repaid to the individual's RRSP over fifteen years, beginning with the second year following the year of withdrawal. Over this period, annual repayments must be equal to at least one-fifteenth of the amount withdrawn. If a person fails to repay the minimum due, he or she must include it in his or her income for the year. If a person fails to purchase a home, he or she must repay the amount withdrawn for that purpose by the end of the following year to avoid being taxed on the amount withdrawn under the HBP. Repayments of withdrawn amounts are not deductible in calculating income for a taxation year, since they have already been deducted in a previous year.[16]

In February of 2009, the federal government included several new initiatives in its Economic Action Plan to assist first-time home buyers. Firstly, it announced that it intended to increase the amount that could be withdrawn from an RRSP to purchase a first home by qualified individuals to Can$25,000, and create a First-Time Home Buyers Tax Credit that would provide for up to Can$750.[17] The Economic Action Plan also provides Can$1 billion over the next two years to encourage individuals to install energy-saving retrofits and energy efficiency upgrades. A slightly larger amount was budgeted to build more senior housing, housing for persons with disabilities, and housing for aboriginal people in the northern part of Canada.[18]

III. Canada Mortgage and Housing Corporation

The Canada Mortgage and Housing Corporation (hereinafter referred to as "the CMHC") is Canada's national housing agency. The CMHC was created by the National Housing Act[19] approximately sixty years ago. In the 1940's its primary function was to provide discounts for loan and mortgage companies and to work with the provinces to create public housing for low-income families. In the 1950's the CMHC began giving grants to cities to encourage them to build municipally-owned housing corporations. In 1954, CMHC introduced Mortgage Loan Insurance. Originally, CMHC would guarantee loans if the purchaser made a down payment of twenty-five percent. In 1999, the CMHC began guaranteeing loans for purchases of houses if the borrower made a down payment of five percent of the purchase price. Originally designed as a

[16] Income Tax Act, R.S.C. ch. 1, § 146.01 (5th Supp. 1989), *as amended*, *available at* http://laws.justice.gc.ca/en/showtdm/cs/I-3.3 (last visited Mar. 16, 2009).

[17] News Release, Canada Revenue Agency, Canada's Government Introduces Financial Help for First-Time Home Buyers, Feb. 2, 2009.

[18] Canada Mortgage and Housing Corporation (CMHC), *Economic Action Plan Supports Canada's Social Housing Needs and Creates Jobs*, Feb. 5, 2009, http://cmhc.gc.ca/en/corp/nero/nere/2009/2009-02-05-9000.cfm (last visited Mar. 16, 2009).

[19] National House Act, R.S.C. ch. N-11 (1985), *as amended*, *available at* http://laws.justice.gc.ca/en/showtdm/cs/N-11 (last visited Mar. 14, 2009).

pilot project that would last five years, the five percent threshold eventually became a permanent one that has continued until the present time.[20] The reduction from twenty-five to five percent has made the CMHC the leader in its field. Approximately eighty percent of home mortgages in Canada are now backed by CMHC. AIG and a number of other guarantee companies account for the remainder of residential loan guarantees in Canada.[21]

Between 1954 and 1999, CMHC introduced a number of programs designed to assist low-income people attain home ownership, to encourage rehabilitation of substandard homes, and promote healthy housing. In 2005, CMHC introduced a ten percent "green refund" on Mortgage Loan Insurance premiums for persons who buy or build an energy-efficient home or make energy-saving renovations to their existing homes.[22]

IV. Concluding Remarks

In Canada, lenders can sell or foreclose on property that is covered by a mortgage that is in default relatively quickly. Non-judicial sales in the power of sale provinces is the fastest method. Judicial sales in the provinces that require sales to be supervised by the courts can take up to two years. Foreclosure is not resorted to in Canada as often as judicial and non-judicial sales because it prevents the lender from proceeding against the borrower for any deficiency, and proceedings to take title to a property covered by a mortgage in default is expensive.

Canada does not allow individuals to deduct mortgage interest in calculating their income tax. However, Canada does have tax incentives that encourage home ownership. In addition to a principal residence exemption from capital gains tax, and tax credits for first home buyers and energy saving renovations, Canada allows individuals to withdraw up to Can$25,000 from their Registered Retirement Savings Plans to purchase a first home or a home for a disabled person. Withdrawals must be repaid over fifteen years or they will incur tax liability.

Canada's national housing agency is the CMHC. The CMHC guarantees loans for the purchase of a residential property if the purchaser puts down at least five percent of the purchase price as a down payment. CMHC also administers a number of other programs that were created by the federal government to promote energy efficiency and savings, and to assist low-income individuals, persons with disabilities, and aboriginal communities in the northern part of Canada.

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[20] Canada Mortgage and Housing Corporation, *History of CMHC*, http://www.cmhc-schl.gc.ca/en/corp/about/hi/index.cfm (last visited Mar. 16, 2009).

[21] Information obtained from a telephone interview with CMHC conduced on Jan. 14, 2009.

[22] CMHC, *supra* note 18.

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ENGLAND AND WALES

HOUSING FINANCE LEGISLATION

Executive Summary

England and Wales is facing similar difficulties as the United States over the past few years with the decline of the housing market. The government has responded to this by providing assistance to certain homeowners under a variety of mortgage "rescue" programs.[1] *Foreclosure laws are robust and the courts and lenders are actively working with borrowers to come to a solution to enable those struggling to maintain home ownership.*

I. Introduction to Mortgages

There are currently 11.7 million mortgages in the United Kingdom (UK), worth over £1.2 trillion.[2] There are no legal requirements for down payments to buy a home in England and Wales. The down payment requirements are set by the lenders, and can be up to one hundred per cent of the value of the property in some instances if the lender believes the borrower has a high enough income.[3] The main legal requirement affecting mortgages of land in England and Wales is that they must be conducted by way of deed; however, certain mortgages can be equitable mortgages.[4]

There is no statutory form that mortgages are required to take, although the Financial Services Authority (FSA) regulates the financial services industry, which includes first residential mortgages where the borrower, or a related person, utilizes forty percent of the property as a dwelling.[5] In order to sell a mortgage in England and Wales, the seller must be regulated by the FSA. The FSA's objectives are to maintain market confidence, promote public understanding of the financial system, secure the appropriate degree of protection for consumers, and fight financial crime.[6] If it considers that mortgages have been wrongly sold, the FSA may

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[1] These programs are referred to as "schemes" in the UK; hence, the program names below.

[2] Council of Mortgage Lenders, *Simple Steps for Mortgage Troubles*, Feb. 18, 2009, http://www.cml.org.uk/cml/media/press/2118. Note that 1 UK Pound = 1.40055 U.S. dollars as of March 17, 2009.

[3] Directgov.uk, *How lenders decide how much you can borrow*, http://www.direct.gov.uk/en/MoneyTaxAndBenefits/ManagingMoney/Mortgages/DG_10015011 (last visited Mar. 12, 2009).

[4] Law of Property Act 1925, 15 & 16 Geo 5, c. 20, § 52(1).

[5] The Financial Services and Markets Act 2000, c. 8, *as amended*.

[6] *Id*. §§ 2-6.

impose any financial penalty it considers to be appropriate, publicly censure the company or individual and/or prohibit them from performing the regulated function.[7]

Prior to regulation by the FSA, mortgages were regulated through a variety of methods and by a variety of bodies. The government's Office of Fair Trading covered complaints about mortgage lending. Banks and Building Society's Ombudsmen resolved complaints if the firms' own procedures did not satisfy customers. The Financial Services Authority regulated the marketing and advice of investments that were used as mortgage repayment vehicles, such as endowment policies.[8] As mortgages were considered to be consumer contracts, they were also subject to the Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994/3159), which made unfair terms unenforceable. The Director General of Fair Trading was responsible for enforcing these regulations. Lastly, a voluntary Mortgage Code was adopted by members of the Council of Mortgage Lenders, covering 98 percent of the mortgage market.[9]

II. Tax Relief for Mortgages

There is no current program for tax relief for mortgage interest in the UK.[10] The last mortgage interest relief program (the mortgage interest relief at source program – MIRAS)[11] was removed on April 6, 2000, by the Finance Act 1999.[12] Prior to this, over fifty pages of primary legislation and one hundred pages of regulations from Her Majesty's Inland Revenue were devoted to the provisions of mortgage tax relief.[13] This tax relief on mortgages has been progressively reduced since 1988.[14]

The MIRAS system was first introduced in April 1983[15] when tax relief was provided on the interest on £30,000 of a loan, with the borrower paying the lender the interest, less the tax relief.[16] The lender was then reimbursed by the Inland Revenue for the amount deducted. The initial deductions were the basic rate of income tax up to 1993 when the rate of relief was twenty percent, dropping to fifteen percent for the period 1995-1998, then dropping to ten percent from

[7] *Id*. § 66. An example of the FSA performing these powers is the Final Notice given to Edward Allen, Nov. 4, 2008, *available at* http://www.fsa.gov.uk/pubs/final/edward_allen.pdf.

[8] Financial Services Act 1986, c.60.

[9] HM Treasury, *Regulation of Mortgages: A Discussion Document* (July 20, 1999), http://www.hm-treasury.gov.uk/fin_mort_disc.htm.

[10] 6 Taxation of Individuals in Europe: United Kingdom ¶ 4.5 (2007).

[11] The principal regulation governing this program was the Income Tax (Interest Relief) Regulations 1982, SI 1982/1236.

[12] Finance Act 1999, c. 16. *See also* Her Majesty's Revenue and Customs, *Mortgage Interest Relief* ¶ 2, *available at* http://www.hmrc.gov.uk/stats/mir/intro.pdf (last visited Mar. 12, 2009).

[13] Her Majesty's Revenue and Customs, *Regulatory Impact Assessment: Withdrawal of Mortgage Interest Relief and MIRAS* ¶ 30 (Feb. 2000), http://www.hmrc.gov.uk/ria/miraswithdrawal.pdf.

[14] *Id*.

[15] The principal regulation governing this program was the Income Tax (Interest Relief) Regulations 1982, SI 1982/1236.

[16] Her Majesty's Revenue and Customs, *Mortgage Interest Relief* ¶ 5.

1999-2000 when it was ultimately abolished.[17] The aim of withdrawing this tax relief was "to contribute to the long-term stability of the economy and to help improve the functioning of the housing market."[18] As lenders were responsible for ensuring borrowers had the correct paperwork completed as well as claiming the money back from the Inland Revenue, it was estimated that the abolishment of this system would save them between £50 to £80 million.[19] The government believed that the benefits that borrowers would see as a result of abolishing this tax was the development of more flexible mortgages as:

> Mortgage lenders believe that the regulations surrounding MIRAS have inhibited the development of more flexible mortgages, and that their withdrawal will have a positive impact upon the range of mortgage products available. They anticipate that products providing payment holidays, flexible payment options, foreign currency options etc. will become more common after April 2000.[20]

III. Foreclosure

Foreclosure laws in England and Wales have developed through the common law and been modified by statute. The effect of foreclosure in England and Wales is that the mortgagor loses all rights in the affected property and vests absolute ownership of the property in the mortgagee.[21] At common law, the rights of the mortgagee depend upon the terms of the mortgage document. If the mortgagor does not make the appropriate payments on time, they no longer have any rights to the secured property. However, in equity the mortgagor has a right of redemption – that is, they can "recover the property on payment of the secured indebtedness."[22] The only way the mortgagee can extinguish this equity of redemption is to apply to the court for an order that the mortgagor no longer has the right to redeem. Thus, foreclosure must be effected by an order of the court and "in the strict legal sense it is nothing more than the destruction of the equity of redemption which has previously existed."[23]

The mortgagee may make an application to the court for an order of foreclosure once the monies on the secured debt become repayable. The Court then requires:

> An account to be taken of the amount of the secured indebtedness and will give the debtor a period of time (normally 6 months) to repay it, failing which it will make a foreclosure order absolute. This will have the effect of barring the debtor's equity of redemption and the rights of any subsequent encumbrances, and will therefore make the [mortgagor] the absolute owner of the property concerned.[24]

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[17] *Id*.

[18] Her Majesty's Revenue and Customs, Regulatory Impact Assessment: Withdrawal of Mortgage Interest Relief and MIRAS ¶ 29.

[19] *Id*. (generally).

[20] *Id*.

[21] RICHARD CALNAN, TAKING SECURITY ¶ 2.53 (2006).

[22] *Id*. ¶ 8.54.

[23] Re Farnol Eades Ervine & Co., [1915] 1 Ch. 22, 24.

[24] CALNAN, *supra* note 21, ¶ 8.55.

If the mortgagor applies for a foreclosure order, the mortgagee can place a request to the court that the property be sold.[25] The court has discretion whether to grant this order; however, if the value of the property is greater than the debt it will typically do so, as foreclosure would penalize the debtor.[26]

The effect of foreclosure is that the mortgagor becomes the absolute owner of the property. If the property is then sold for less than the mortgage was worth the mortgagor cannot recover the difference from the mortgagee.[27]

IV. Possession – Statutory

Mortgagees in England and Wales have additional remedies for default of payment – that of possession. It is more common for mortgagees to take possession of a property (commonly referred to as "repossession") and then exercise a right of sale than to use foreclosure proceedings.[28]

The Administration of Justice Acts 1970 and 1973 govern the proceedings for the majority of possessions in England and Wales. Section 36(1) of the Administration of Justice Act 1970 provides that:

> Where the mortgagee under a mortgage of land which consists of or includes a dwelling-house brings an action in which he claims possession ... the court may exercise any of [its] powers ... if it appears to the court that in the event of its exercising the power the mortgagor is likely to be able within a reasonable period to pay any sums due under the mortgage or to remedy a default consisting of a breach of any other obligation arising under or by virtue of the mortgage.

The courts have discretion to adjourn these procedures, or to stay or suspend the execution of the judgment, or order or postpone the date for delivery of possession, for any period that it considers is reasonable.[29] To obtain a stay or suspend the execution of a judgment or order, the borrower must satisfy the court on the balance of probabilities that it is likely they can clear the arrears within a reasonable period.[30] If there is no probability of the borrower reducing the arrears, the court cannot suspend the order for possession, regardless of the circumstances.[31]

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[25] Law of Property Act 1925, 15 & 16 Geo. 5, c. 20, § 91(2).

[26] CALNAN, *supra* note 21, ¶ 8.63.

[27] Lockhart v. Hardy (1846) 9 Beav 349.

[28] The Law of Personal Property Security (Hugh Beale et al., eds., 2007).

[29] Administration of Justice Act 1970, c. 31 § 36(2).

[30] Abbey National Mortgages v. Bernard, (1995) 71 P&CR a 57 (CA).

[31] *Id*.

The term "reasonable period" is not defined in the Act and is subject to a number of interpretations. Ultimately, it has been determined that what is reasonable depends upon the circumstances of the case, and in certain circumstances may extend to the end of the mortgage term.[32] Guidance has been provided by the Court of Appeal, which notes that "the court should take as its starting point the full term of the mortgage and pose at the outset the question: would it be possible for the mortgagor to maintain payment off of the arrears by installments over that period?"[33] In certain instances, the courts may also stay or suspend an order for possession to allow the mortgagor to sell the house to earn sufficient money to discharge the mortgage debt. In one instance, the court allowed a stay of one year to enable the sale of the property;[34] however, the ultimate consideration before the courts is the safety of the mortgagee's security.[35] Thus, the court would have to consider what effect a delay in a declining market would have on the ability of the mortgagor to discharge the mortgage debt. In Cheltenham & Gloucester B.S. v. Norgan[36] the court considered whether it had the authority under section 36 of the Administration of Justice Act 1970 to extend the "length of the mortgage term in this way … it is argued later that there is no power at present for the court to extend the contractual mortgage term under section 36."[37]

In 2008, the Civil Justice Council issued a pre-action protocol for mortgage possession cases. This requires mortgagees to discuss alternative arrangements to repossession and lists a number of criteria in which repossession by the mortgagee should be postponed. If the case ultimately reaches court, the mortgagee will be required to provide details of the support that they have offered and is intended to affirm that repossession should be a last resort.[38]

V. Possession – Common Law

The Administration of Justice Act 1970 is not the only mechanism through which the mortgagee can take possession of the mortgaged property. A right exists at common law for a mortgagee to take possession of the mortgaged property without a court order. Section 36 of the Administration of Justice Act 1970 did not abrogate this right.[39] The mortgagee's right of possession has been determined to arise as soon as the mortgage document is entered into, even in the absence of default, unless expressly or impliedly limited by the terms of the mortgage

[32] Western Bank v. Schindler, [1977] Ch 1.

[33] Gloucester Building Society v. Norgan, [1996] 1 All ER 449, 458.

[34] National and Provincial Building Society v. Lloyd, [1996] 1 All ER 630, CA. *But see* Cheltenham & Gloucester plc v. Krausz, [1997] 1 All ER 21, CA, in which the court determined that this would only be the case if the proceeds from the sale would discharge the entire mortgage debt.

[35] Bristol & West Building Society v Ellis, (1997) 29 HLR 282, CA.

[36] Cheltenham & Gloucester B.S. v Norgan, [1996] 1 WLR 343, CA.

[37] L.M. Clements, *Residential Mortgage Repossessions and The Administration of Justice Acts, 1970 and 1973 – A case for Reform*, 3 WEB JCLI (1999) , *available at* http://webjcli.ncl.ac.uk/1999/issue3/rtf/ clements3.rtf.

[38] Civil Justice Council, Pre-Action Protocol for Possession Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property, *available at* http://www.civiljusticecouncil.gov.uk/files/ Mortgage_Arrears_Pre-Action_Protocol.pdf (last visited Mar. 12, 2009).

[39] Ropaigealach v. Barclays Bank Plc, [2000] QB 263.

document.[40] However, this power is typically only exercised when the mortgagee's power of sale becomes exercisable under the Law of Property Act 1925,[41] normally only on default. Most mortgagees would not want possession for themselves, since the appointment of a receiver is preferable and does not attract the same burden of accountability to the mortgagor.[42] Additionally, the courts have ruled that until the power of sale becomes exercisable the "right to possession can only be exercised to protect the security, not as a means of enforcing it."[43]

VI. Sale

Once the property has been possessed, there is a statutory power of sale under sections 101 and 103 of the Law of Property Act 1925. These provide the mortgagee with the power to sell when the secured debt has become payable either privately or through auction and without having to apply to the courts.[44] The law provides that the mortgagee can only exercise this power of sale when certain criteria are met (although these can, and are frequently, excluded in the mortgage document), including situations where:

- The principal is in arrears for three months after a notice requiring payment has been served upon them;
- The interest is in arrears for two months; or
- The mortgagee has committed a breach of the mortgage document.[45]

Once the mortgagee enters into a contract to sell the property, the mortgagor looses their right to redeem.[46] If the mortgagee sells the property at a price above the value owed to them the balance is then held on trust for the mortgagor by the mortgagee.[47]

VII. Housing Finance Systems

Mortgages in England and Wales are funded from private banks or building societies. The government offers a number of programs to support people that face unemployment maintain their mortgage payments. A long-running program is the Support for Mortgage Interest (SMI) program,[48] which is aimed at homeowners that receive Income Support, income-based Jobseeker's Allowance, or income-related Employment and Support Allowance. Under this

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[40] Western Bank v. Schindler, [1977] ch. 1.

[41] Law of Property Act 1925, 15 & 16 Geo. 5, c. 20, § 101.

[42] *Id*. § 109(2).

[43] Western Bank v. Schindler, [1977] ch. 1, 10 per Buckley, LJ.

[44] Law of Property Act 1925, 15 & 16 Geo. 5, c. 20, §§ 101 and 103.

[45] *Id*. § 103.

[46] Property & Bloodstock v. Emerton, [1968] Ch. 94.

[47] Law of Property Act 1925, 15 & 16 Geo. 5, c. 20, § 105.

[48] Employment and Support Allowance Regulations 2008, SI 2008/794; Income Support (General) Regulations 1987, SI 1987/1967; and Jobseeker's Allowance Regulations 1996, SI 1996/207, *as amended by* Social Security (Housing Costs Special Arrangements) (Amendment and Modification) Regulations 2008, SI 2008/3195.

program, eligible homeowners must wait for thirteen weeks (down from thirty-nine due to the current financial crisis) before they can receive payments on interest on their mortgage of up to £200,000, up from £100,000.[49] This program lasts for two years from the time that the eligible participant starts receiving money. The rate of interest on which the SMI is calculated is the Standard Rate of Interest; however, this is currently frozen at 6.08 percent from December 2008 to May 2009 due to the financial crisis.[50]

VIII. Programs as a Result of the 2008-2009 Financial Crisis

As in the recession of the early 1990s, the government has introduced additional plans to support individuals that are struggling to make mortgage payments as a result of the recent financial crisis. The plans in many ways mirror those of the 1990s, such as changes to stamp duty (tax on the sale of houses) to try and stimulate house sales,[51] a mortgage rescue program, and changes in government support for mortgage interest payments to help slow and avert foreclosures.[52] The government has also expanded free legal advice across the country for homeowners facing repossession and provided an additional £15 million for free debt advice services.[53]

In addition to government-led programs, the financial industry has introduced a number of measures, as in the 1990s, to avert the large numbers of foreclosures. These include a Code of Conduct with a standard period (currently at least three months) before repossession is sought, restructuring debt over the entire term of the mortgage loan, reducing payments for certain periods of time, and allowing repayment of arrears by small amounts over a long period of time.[54]

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[49] The government estimated that reducing the waiting time from thirty-nine weeks to thirteen will: "reduce repossessions by up to 5,000 per annum which would be an annual saving to exchequer costs of around £20 million." MERITS OF STATUTORY INSTRUMENTS COMMITTEE, FIFTH REPORT: DRAWING SPECIAL ATTENTION TO: SOCIAL SECURITY (HOUSING COSTS SPECIAL ARRANGEMENTS) (AMENDMENT AND MODIFICATION) REGULATIONS 2008 REPORT AND ORAL EVIDENCE CORRESPONDENCE: SAFEGUARDING VULNERABLE GROUPS ACT 2006 (PRESCRIBED CRITERIA AND MISCELLANEOUS PROVISIONS) REGULATIONS 2009, (2008-9) HL 27.

[50] The Social Security (Housing Costs Special Arrangements) (Amendment and Modification) Regulations 2008 SI 2008/3195.

[51] In the 1990s the threshold for stamp duty was increased from £30,000 to £250,000, removing at the time 99 percent of property purchases from the requirement to pay stamp duty. Today, the threshold has been increased from £125,000 to £175,000. It is reported that this drop in stamp duty will not have the effect as it did in the 1990s when it stimulated sales enabling homeowners to extricate themselves from debt during the earlier stages of the housing market decline. The stamp duty reduction has not yet stimulated house sales, and in fact the last quarter of 2008 saw a substantial decline in sales. M. STEPHENS, ET AL., HOUSING MARKET RECESSIONS AND SUSTAINABLE HOME OWNERSHIP (Joseph Rowntree Foundation, 2008), *cited in* NATALIE ELPHICKE, POINTMAKER: SAVE 100,000 HOMES FROM REPOSSESSION 4 (Centre for Policy Studies, Feb. 2009), *available at* https://www.cps.org.uk/cpsfile.asp?id=1087.

[52] ELPHICKE, *supra* note 51.

[53] News Distribution Service, *Communities and Local Government: Mortgage rescue scheme extended across England*, Jan. 16, 2009, http://nds.coi.gov.uk/content/detail.asp?NewsAreaID=2&ReleaseID=389912.

[54] ELPHICKE, *supra* note 51.

A. Mortgage Rescue Program

The mortgage rescue program is a government-led £200 million initiative to "prevent [up to 6,000] of the most vulnerable families losing their homes and experiencing the trauma of repossession."[55] It applies to houses valued below £145,000 that are not in negative equity.[56] The gross household income must be less than £60,000 per year and contain individuals that would "be entitled to be re-housed under homelessness legislation. These would be people who are elderly, pregnant, disabled or those with children."[57] This program is designed to allow homeowners to reduce their mortgage payments through a shared equity option in which a portion of their interest is sold to a housing association enabling the monthly mortgage payment to be reduced, or to sell the property outright to the association and remain in the property as tenants on subsidized rents (typically eighty percent of the open market rent).[58] It is designed to be an alternative to the currently unregulated sale and rent back programs and is operated by local authorities.[59]

B. Homeowner Mortgage Support Scheme

In December 2008 the government introduced a program known as the Homeowner Mortgage Support Scheme. This program, which will operate for an initial period of two years, allows borrowers that meet certain criteria to apply to lenders to have their monthly mortgage payments reduced and is aimed at homeowners facing a sudden and temporary loss of income. The difference between the reduced amount and original amount would be added to the principal "and paid at a later date when the borrower's financial circumstances have improved."[60] The government is guaranteeing lenders against any loss on the deferred interest payments in cases where the borrower defaults.[61]

The program is voluntary and "subject to eligibility criteria to ensure that there is proper risk sharing between Government, lenders and borrowers and the scheme is sustainable for those that participate."[62] Currently, the eight major lenders in the UK, making up seventy percent of the mortgage markets, have agreed "in principle to support the new scheme."[63]

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[55] News Distribution Service, *supra* note 53.

[56] Northampton Borough Council, *The Mortgage Rescue Scheme*, http://www.northampton.gov.uk/site/scripts/documents_info.php?categoryID=952&documentID=685 (last visited Mar. 12, 2009).

[57] News Distribution Service, *supra* note 53.

[58] Northampton Borough Council, *supra* note 56.

[59] News Distribution Service, *supra* note 53.

[60] HM Treasury, *The Homeowner Mortgage Support Scheme*, Dec. 10, 2008, *available at* http://www.hm-treasury.gov.uk/press_135_08.htm.

[61] *Id*.

[62] *Id*.

[63] Id. The eight major lenders in England and Wales are: HBOS, Nationwide, Abbey, Lloyds TSB, Northern Rock, Barclays, RBS, and HSBC.

The criteria to qualify for the program are that borrowers will:

- Have suffered a loss of income from employment or self-employment of a scale which now makes full mortgage payments difficult, but which is not expected to be a permanent loss of income;
- Have been in dialogue with their lender, including over the use of existing forbearance policies, and have been making some level of regular payment;
- Have taken out a mortgage of up to £400k;
- Have savings below £16,000, (which is the same as for the existing Support for Mortgage Interest program (SMI));
- Apply for assistance as owner-occupier – the program will not apply to people with second homes or buy-to-let properties;
- Not be in receipt of SMI or mortgage rescue assistance;
- Have been assessed as being able to pay a certain monthly amount on an ongoing basis;
- Have received financial advice from a party other than their lender to determine their eligibility for the program, including testing the long-term sustainability of their financial position, and their ability to resume full payments once their income increases; and
- Have fallen into arrears for a number of months during which the lender has exercised forbearance. [64]

The program itself will be open for a window of two years, subject to review. The guarantee will last for a maximum time period and will expire once the customer is able to commence normal payments. If, during the period of guarantee, the customer defaults, the Government will pay the lender the equivalent sum of the total amount of the interest guaranteed that is not recoverable from equity in the property.

IX. Concluding Remarks

A report from the Centre for Policy Studies notes that the government measures, such as stamp duty relief, the mortgage rescue program, and the homeowner mortgage program, are collectively not that useful to the average homeowner facing repossession. The report claims that only a small number of homeowners are able to utilize government mortgage programs, leading to high average per household operating costs. The report claims that the ultimate assistance during the housing recession of the 1990s:

> was the court process which did most to help households in need [as] there is a high degree of judicial discretion in deciding civil claims and this judicial discretion allows a court to postpone, adjourn, stay or suspend a claim for repossession. During the last housing recession the exercise of judicial discretion for mortgage repossession orders has two consequences: the length of time during which a borrower could demonstrate his ability to make repayments was lengthened considerably; [and] the number of repossessions orders which were suspended increased between 1990 – 1994.[65]

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[64] HM Treasury, *supra* note 60.

[65] ELPHICKE, *supra* note 51.

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FRANCE

HOUSING FINANCE LEGISLATION

Executive Summary

The French law governing the procedure for the forced sale of real estate was amended in 2006. The procedure remains complex and lengthy despite the changes. A percentage of the interest incurred on a loan taken for the purchase or the construction of the taxpayer's main residence is tax deductible. The tax credit is given for the five initial years of the loan. The property must comply with specific thermal and energy standards. A tax credit is also available for expenses improving "the environmental quality of the home" under certain conditions. The capital gain made on the sale of a taxpayer's main residence is exempt from taxation as long as the sale of the property occurs within one year from the time the owner moved out of his property.

French housing policy is based on two principles: a right to housing, which was made a fundamental right in 1989, and freedom of choice in terms of housing, including the type of ownership, type of housing, and location. Housing finance for home ownership includes free market loans, regulated loans, and subsidized loans. The Caisse des Dépôts et Consignations is the primary public lender to finance loans for social housing and urban renewal.

I. Foreclosure

The repossession of a home by a bank falls under the provisions governing the forced sale of real estate property (*saisie immobilière*). Provisions on this subject go back to the thirteenth century. The Napoleonic Civil Code, first enacted in 1804, contained a full title on the forced sale of real estate property. Provisions were also included in the Civil Procedure Code of 1806. There were numerous amendments through the years, including a 1991 law on Civil Enforcement Procedures, that partly reformed this procedure, which has always been very complex due to the various interests at stake that need to be safeguarded.[1]

A major reform to consolidate all the changes was adopted and was accomplished in 2006 by Ordinance 2006-461 of April 21, 2006[2] and its implementing Decree.[3] A report

[1] Stéphane Piedeliévre and Frédéric Guerchoun, "Saisie Immobilière," *in* RÉPERTOIRE DE PROCÉDURE CIVILE, §§ 4 to 15 (Dalloz 2007).

[2] Ordonnance No. 2006-461 du 21 Avril 2006 réformant la saisie immobilière, JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [Official Gazette of France], Apr. 22, 2006, p. 6072. These provisions were incorporated in various codes, including the Civil Code, the Commerce Code, and the Consumer Code.

prepared for the President of the Republic by the Prime Minister's Office and the Ministry of Justice summarized the main goals of the reform as including:[4]

- Setting forth a common base for regulating expropriation;
- Guaranteeing the balance between the rights of the debtor and the creditors interests by reinforcing the role of the enforcement judge (*juge de l'éxecution*) and requiring representation of the debtor by an attorney;
- Rendering the debtor accountable by authorizing him to sell his property through an amicable sale;
- Rendering the procedure secure in requiring payment guarantees from the buyer; and
- Simplifying and speed up the procedure in limiting the number of dilatory claims.

Despite the changes, the procedure still remains lengthy. A bank (or a creditor) has first to obtain a judgment ordering the debtor to reimburse the sums due.[5] Once the judgment is rendered, the forced sale procedure starts. It can be summarized in the following eight steps:[6]

1. A bailiff (*huissier de justice*) serves the debtor with a document ordering him to pay the sum due within eight days. The document is called a *commandement*;

2. This *commandement*, like most of the ensuing documents, must be published at the local land registry. Publication must occur within two months from the service date. If the debtor attempts to sell his property during the forced sale procedure, he will be discovered. The publication date is also the starting point for a two-year period during which the sale must occur and be registered at the land registry;

3. At the expiration of the eight days, the bailiff is authorized to enter the property to prepare a description of such property, which is included in a document entitled *cahier des conditions* drafted by the bank attorney and setting forth the conditions of the sale;

4. Within two months following the publication of the *commandement* in the land registry, the debtor receives a summons to appear at an "orientation hearing" before the competent judge (*juge de l'exécution*);

5. At the orientation hearing, the judge reviews whether all the conditions for the sale are met and rules on any incidental claims. He then orders either an amicable sale or a forced sale. The orientation judgment may be appealed within fifteen days;

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[3] Décret 2006 of July 27, 2006, relative aux procédures de saisie immobilière et de distribution du prix d'un immeuble, J.O., July 29, 2006, p. 11316.

[4] Rapport au Président de la République relative à l'ordonnance No 2006-461 du 21 Avril 2006 réformant la saisie immobilière, J.O., Apr. 22, 2006, p. 6068.

[5] Ordonnance No. 2006-461 du 21 Avril 2006, art. 2.

[6] *Id*. arts. 2, 3, 12.

6. The decision to allow an amicable sale suspends the procedure. The judge sets forth a date for a new hearing, which must take place within four months at the most. At this hearing, the judge reviews the deed of sale if the sale took place. If not, he may grant an extension of up to three months or order a forced sale.

7. The judge sets forth the date of the forced sale and the conditions of the visits to the property. Advertisements of the forced sale are posted in the court and in two local and regional newspapers.

8. At the auction hearing, the bank is deemed the purchaser of the real estate at the minimum opening bid price if there is no other bid. Any person may ask for the property to be re-auctioned within a period of ten days of the first auction if that person is prepared to pay at least an additional ten percent of the price obtained at auction. The sale deed is published in the land registry.

II. Tax Treatment of Owner-Occupied Homes

The General Tax Code provides that the owner who enjoys the free use of his property is not taxable on the benefit in kind resulting from such use. As a result there is no tax credit for the expenses incurred for the maintenance of the property, with the exceptions addressed below.[7]

There is a tax credit for interest incurred on loans concluded on or after August 22, 2007, for the purchase or the construction of the taxpayer's main residence. The tax credit is given for the five initial years of the loan. The property must comply with specific thermal and energy standards. The tax credit is calculated as twenty percent (forty percent the first year) of the qualifying loan interest. The qualifying loan interest is limited to €3,500[8] for a single person, and €7,500 for a couple. It is increased by € 500 for each dependant. The qualifying interest is €7,500 for a handicapped, widowed, or divorced person living alone. [9]

A tax credit is also available for expenses improving "the environmental quality of the home" (energy-saving and energy-producing heating systems, thermal insulation equipment) paid between January 1, 2005, and December 31, 2012. The tax credit may be spread over a five consecutive year period between January 1, 2005, and December 31, 2012. Depending upon the date the expenses occurred, the tax credit is equal to 25 percent, 40 percent, or 50 percent of the deductible expenses, which are themselves capped throughout the five-year period at €16,000 for a couple and €8, 000 for any other case. The cap is increased by €400 per dependant.[10]

Finally, the capital gain made on the sale of a taxpayer's main residence is exempt from taxation as long as the sale of the property occurs within one year from the date on which the

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[7] CODE GENERAL DES IMPOTS (CGI), art. 15.II., *available at* http://www.legifrance.gouv.fr/home.jsp (File: les Codes en vigueur).

[8] 1 Euro = 1.29745 U.S. dollars as of March 16, 2009.

[9] CGI, art 200 quaterdecies.

[10] *Id*., art. 200 quarter.

owner moved out of his property.[11] The Minister of Economy, Christine Lagarde announced on March 3, 2009, that this rule will be softened. In the current real estate market, it takes sometimes more than a year to sell a house after the owner moves out. This situation would result in the owner having to pay a capital gains tax. To avoid this result, a regulation will be issued stating that the one-year period is extended to two years for sales occurring between 2009 and 2010.[12]

III. Housing Finance System

A. General Information

The French housing policy is based on two principles: a right to housing, which was made a fundamental right in 1989, and freedom of choice in terms of housing, including the type of ownership, type of housing, and location. Housing finance for home ownership includes free market loans, regulated loans, and subsidized loans.[13] Approximately fifty-seven percent of the French population are home owners.[14]

Financing of regulated and subsidized loans comes from several sources. They include the state budget, the *Caisse des Dépôts et Consignations*, the *Crédit Foncier de France*, the employers' contribution, referred to as the "1 percent logement," and funds contributed by the local authorities.[15]

The *Caisse des Dépôts et Consignations* is "a public financial institution that performs public interest missions on behalf of France's central, regional and local governments."[16] The *Caisse* centralizes and manages the saving deposits gathered by several saving banks, such as the Caisse d'Epargne and the Caisse Nationale d'Epargne de la Poste. These institutions offer *Livret A* savings books, each with a deposit ceiling of €15,300. They receive a regulated interest of 2.50 percent at this time. They are guaranteed by the state and the interests are tax exempts. There are approximately 47 million of theses saving accounts currently in circulation. At the end of 2006, for example, the centralized savings deposits stood at €191.7 billion. The *Caisse* is the

[11] *Id*. art. 150U.

[12] *Plus-values immobilières: Bercy va assouplir le dispositif*, LES ECHOS.FR, Mar. 6, 2009, http://www.lesechos.fr/patrimoine/impots/300334223-plus-values-immobilieres-bercy-va-assouplir-le-dispositif.htm (last visited Mar.10, 2009).

[13] ANNE MARIE FRIBOURG (UPDATED BY FABRICE AUBERT), LE FINANCEMENT DU LOGEMENT EN FRANCE 15 (Ministère de l'Ecologie, de l'Energie, du Développement Durable et de l'Aménagement du Territoire, Centre de Documentation, 2005), http://www.cdu.urbanisme.equipement.gouv.fr/article.php3?id_article=207 (last visited Mar. 10, 2009).

[14] BENEDICTE CASTÉRAN AND LAYLA RICROCH, LES LOGEMENTS EN 2006 (Institut National de la Statistique et des Etudes Economique, July 2008), *available at* http://www.insee.fr/fr/themes/document.asp?ref_id=ip1202 (click on "version imprimable") (last visited Mar. 10, 2009).

[15] FRIBOURG & AUBERT, *supra* note 13, at 18.

[16] Caisse des Dépôts et Consignations, *Activités: Financement du logement social*, http://www.caissedesdepots.fr/spip.php?article24 (last visited Mar.10, 2009).

primary lender to finance loans for social housing and urban renewal. It converts short-term deposits into long-term loans.[17]

The *Crédit Foncier* was created in 1852. Originally, it was a public financial institution, which had a quasi-monopoly on the distribution of government subsidized loans. The *Crédit Foncier* was privatized in 1999. It is a top mortgage specialist bank whose principal activity is in government subsidized loans and local authority funding.[18]

The employers' contribution was made mandatory in 1953. Each year, employers who employ twenty or more employees are required to make a contribution to help the construction of housing for employees. The rate of contribution is 0.45 percent of all salaries the employer paid during the preceding year. This rate used to be one percent. This is why this scheme is still referred as the "1 percent logement."[19] These funds are used for loans or grants to promote rental accommodations and home ownership.

B. Free Market Loans

The financial conditions of a loan that a bank or a financial establishment grants to a borrower for the purchase of a home depend on the financial profile of the borrower. The bank evaluates the financial risk posed by the borrower. If it is low, the bank offers its best financial conditions.[20] As a general rule, a bank will require a borrower to deposit between ten to thirty percent of the price of a house as a down payment. The 2007 annual report prepared by the Banking Commission states that the average down payment was 22.5 percent.[21]

C. Subsidized Loans

1. Zero-interest Loans

First-time homebuyers who have a moderate income may qualify for a zero interest loan. These loans are subject to means testing. The annual income ceilings depend on the make-up of the household and the geographic zone where the property is located. The amount of the loan granted depends on several criteria including, for example, the age of the property, the income of the purchaser, and the make-up of the household. The repayment period depends on the income of the purchaser and can be from six years to twenty-two years. These loans are complementary

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[17] *Id*.

[18] Crédit Foncier, *Histoire*, http://www.creditfoncier.fr/editorial/Institutionnel/Histoire_en_bref.shtml (last visited Mar. 10, 2009).

[19] CODE DE LA CONSTRUCTION ET DE L'HABITAT arts. L313-1 to 313-6, *available at* Légifrance, http://www.legifrance.gouv.fr/home.jsp (File: les Codes en vigueur).

[20] Sebastien Neuville, Droit de la banque et des marches financiers 272, 273 (Presses Universitaires de France, 2005).

[21] COMMISSION BANCAIRE, RAPPORT ANNUEL 2007 DE LA COMMISSION BANCAIRE, http://www.banque-france.fr/fr/supervi/telechar/rapport_annuel_cb/rapport-annuel-commission-bancaire-2007.pdf (last visited Mar. 10, 2009).

funding and are granted as a supplement to the main mortgage.[22] The loans are financed by credit establishments that have signed a convention with the state. The state grants the establishment a tax credit equivalent to the amount of the interests it would have earned.[23]

2. Housing Savings Plans

The *plans compte d'epargne logement* (housing savings plans) were established in 1965 to encourage private individuals to build up their savings for home ownership. There are two types of plans: the property savings account is a deposit account with a deposit ceiling of €15,300. After 18 months of saving, the holder of the account may obtain a loan up to €23,000 with a below-market rate. The state also provides for a bonus of €1,144;[24] the property saving plan allows the holder to save up to €61,200 during four years, at which time he may be granted a loan at below-market rate for a maximum amount of €92,000.[25] The state also pays a bonus of €1,525. In both cases, the below-market rate depends upon the rate of interest accrued during the period of saving.

D. Regulated Loans

France has several regulated loans. Among the best known are the *Prêt conventionné* (approved home ownership loan), the *prêt à l'accession sociale à la propriété* (social home ownership loan), and the *Pass foncier* (property pass).

The approved home ownership loan is not means tested and the purchaser may borrow up to 100 percent of the purchase price. The interest rates of these loans are structured by an agreement negotiated between the state and the financial institutions lending the funds. In general, the reimbursement period is between five to thirty years.[26] The social home ownership loan is means tested and is guaranteed by the state, covering payment defaults by borrowers. It can be used to finance up to 90 percent of the cost of a home.[27]

The property pass helps first-time homebuyers with low incomes to purchase a new house without paying initially for the land. It results from an agreement signed in December 2006 between the *Caisse des Dépots et Consignations*, the state, and the 1 percent logement organization that handles the employers' contribution. That agreement took effect for four years starting January 1, 2007. When the house is fully paid, the owner then starts to reimburse the

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[22] Ministère du Logement, *Nouveau prêt à 0%*, http://www.logement.gouv.fr/rubrique.php3?id_rubrique=667 (last visited Mar. 10, 2009).

[23] *Id*.

[24] Ministère du Logement, *Compte épargne logement*, http://www.logement.gouv.fr/rubrique.php3?id_rubrique=736 (last visited Mar. 10, 2009).

[25] Ministère du Logement, *Plan épargne logement*, http://www.logement.gouv.fr/rubrique.php3?id_rubrique=743 (last visited Mar. 10, 2009).

[26] Ministère du Logement, *Prêt conventionné*, http://www.logement.gouv.fr/rubrique.php3?id_rubrique=707 (last visited Mar. 10, 2009).

[27] Ministère du Logement, *Prêt accession sociale*, http://www.logement.gouv.fr/rubrique.php3?id_rubrique=679 (last visited Mar.10, 2009).

cost of the land. There is a cap on the loan that depends on the geographic zone where the property is located. The property pass also guarantees the purchase of the home by the 1 percent logement organization and the re-lodging of the borrower if he is not able to reimburse the loan.[28]

IV. Concluding Remarks

The government housing policy is oriented towards encouraging home ownership. The economic stimulus package adopted in February contains specific measures for housing, such as building an additional 100,000 homes (including 30,000 social housing homes) over a two-year period and doubling until the end of 2009 the number of zero-interest-rate mortgages offered to first-time buyers for the purchase of new housing. It also includes additional financial assistance from the state to help low-income households benefit from the property pass.[29]

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[28] Ministère du logement, *Le Pass foncier*, http://www.logement.gouv.fr/article.php3?id_article=6047&var_recherche=pass+foncier (last visited Mar.10, 2009).

[29] Ministère du logement, *Soutien au logement-effort de construction*, http://www.logement.gouv.fr/IMG/pdf/Soutien_au_logement_cle048618.pdf (last visited Mar.10, 2009).

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GERMANY

HOUSING FINANCE LEGISLATION

Executive Summary

In Germany only 45 percent of the population own their own homes, and financing for family homes has generally been conservative. Nevertheless, Germany has experienced foreclosure rates of 111 and 107 homes per 100,000 inhabitants in the years 2007 and 2008, and in August 2008, Germany enacted legislation to protect home owners against unfair dealings by non-bank purchasers of mortgage-backed securities. These protections augment a system of foreclosure law that always has been considerate of the plight of the debtor by granting judges the power to deny auction sales and evictions that are deemed unfair. In Germany, the auction price must be at least fifty percent of the value of the property and the debtor may remain in the foreclosed property until he is judicially evicted. Creditors never have the right to seize the property.

Currently, there are no significant tax advantages to home ownership. Mortgages were never tax-favored and substantial tax deductions for home purchases or construction were replaced in 1996 by cash grants. Since 2006, Germany has been phasing out this subsidy. Other still existing tax benefits encourage various savings programs for home ownership. In addition, the states subsidize home ownership through low-interest loans.

Germany does not have any federal housing systems or agencies that would administer such programs.

I. Development of Foreclosure Law

A. Economic Background

In Germany, only 45 percent of the population own their homes, while the remaining 55 percent live in rental dwellings.[1] The percentage of home ownership has remained quite stable in recent years, and it has only risen by six percentage points since the end of World War II.[2] Among the reasons for this state of affairs are the conservative practices of mortgage lending and a deeply ingrained distrust of risky investments.[3]

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[1] *Deutschland - das Land der Mieter*, FRANKFURTER ALLGEMEINE ZEITUNG, Jan. 30, 2009, at 45.

[2] *Id.*

[3] S. Kofner, *Hypothekenkrise*, WOHNUNGSWIRTSCHAFT UND MIETRECHT 429 (2007).

Even though sub-prime mortgages are legally possible in Germany, and a few foreign banks have recently begun to offer mortgage conditions that are similar to those available in the United States such as 100 percent and even 120 percent financing, there is not much of a market for such products in Germany.[4] Instead, loan limits of between 50 and 80 percent are typical,[5] and building and savings accounts[6] have fostered a responsible attitude toward investing and home ownership, while covered mortgage bonds of solid value have encouraged real estate financing in a realistic and non-speculative manner.[7]

Nevertheless, there have been a significant number of foreclosures in recent years. In 2007, the number of foreclosures per 100,000 inhabitants was 111, and in 2008, it was 107, amounting to a total of 88,379 foreclosures.[8] Most foreclosures of owner-occupied dwellings were caused by unemployment or divorce. For 2010, higher figures are expected due to the rise in unemployment.[9]

In recent years, concern has arisen in Germany over foreclosures of securitized mortgages. Securitization has been practiced in Germany since 1990, and due to limitations of German law, most asset-backed securities have been purchased by foreign investors.[10] There have been German cases where it was perceived that the non-bank acquirer of securitized mortgage rights had acted in an abusive manner by forcing a foreclosure that was blatantly unfair and unwarranted.[11] It has been alleged that these investors generally are more interested in realizing their expected profit through a foreclosure than in servicing a loan and that they utilize technicalities in the law to foreclose even performing loans.[12] The concern over this situation

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[4] D. Pfeiffenberger, *Baufinanzierung – wie unterstützt die Postbank Drittvertriebe*? IMMOBILIEN & FINANZIERUNG 632 (Sept. 15, 2007), *at* LEXIS/library NEWS/fileZeitng.

[5] ImmobilienScout, *Der nötige Eigenkapitalanteil*, http://www.immobilienscout24.de/de/finanzen/kaufplaner/finanzierung/eigenkapital/index.jsp;jsessionid=DDF6D71B6DFF46B1A190210133A60269.worker2 (last visited Mar. 17, 2009).

[6] Building and savings contracts encourage individuals to save for several years before withdrawing the savings and obtaining a loan for the purchase of housing. *See* Gesetz über Bausparkassen, repromulgated Feb. 15, 1991, BUNDESGESETZBLATT [BGBl, official law gazette of the German Federal Republic] I at 454, as amended, at http://www.gesetze-im-internet.de/bausparkg/BJNR020970972.html.

[7] German banks are licensed to issue bonds that are covered by the mortgages that secure the granted loans. These banking transactions are subject to severe limits and they are tightly supervised to ensure compliance. *See* Pfandbriefgesetz, May 22, 2005, BGBl I at 1373, as last amended by Gesetz, Dec. 21, 2006, BGBl I at 3089.

[8] *Weniger Zwangsversteigerungen*, IMMOBILIEN ZEITUNG. Jan. 8, 2009, *available at* LEXIS/library NEWS/file Zeitng.

[9] *Wirtschaftskrise wird zu mehr Zwangsversteigerungen führen*, ASSOCIATED PRESS WORLD STREAM - GERMAN, Jan. 8, 2009, *available at* LEXIS/library NEWS/file Zeitng.

[10] R. Koch, *Der Schutz des Eigenheims vor den Finanzinvestoren*, ZEITSCHRIFT FÜR BANKRECHT UND BANKWIRTSCHAFT 233 (2008).

[11] As in effect through August 2009, the provisions on the land charge (CIVIL CODE §§ 1191-1198) allowed a creditor to seek foreclosure at any time, even for a performing loan, and the only remedies against such abuse were tort actions for damages.

[12] Koch, *supra* note 10.

has led to the enactment of a Risk Limitation Act in August 2008[13] (see subchapter "Recent Developments") that improves the rights of debtors when their mortgages have been acquired by a non-bank investor.[14]

B. The Legal Framework

The German legal framework for foreclosures was created at the end of the nineteenth century, with the enactment of the Civil Code, the Code of Civil Procedure, and the Forced Auctions Act.[15] Of these, the Civil Code creates the real property securing instruments of the hypothec (§1112) and the land charge (§ 1191) that serve the same purpose as the common law mortgage by allowing for the satisfaction of the secured debt through foreclosure (§ 1147); the Code of Civil Procedure contains in its sections 704 to 945 the general rules for the execution of judgments, and in its sections 864 through 871, the rudiments of foreclosure proceedings for real property. The detailed provisions on forced auctions of real property, however, are implemented through sections 1 through 162 of the Forced Auctions Act.

This German system of foreclosure of real property is in many ways different from foreclosure laws that are found in the United States. It is notable, in particular, that the owner of a German hypothec or land charge is never entitled to seize the encumbered property.[16] Instead, the foreclosure proceeding is commenced with a petition for a forced auction, to be carried out by the court, and throughout this proceeding, the borrower has various defenses and objections.[17]

Yet even if these fail, and the property is auctioned off by the court, this does not always persuade the former owner to leave the property. The debtor, or any other occupant of the property, remains in residence until the new owner persuades him to relinquish possession. Even at that stage the new owner is not entitled to any self-help actions. Instead, he must petition the court to carry out a forced eviction, if the occupier does not leave voluntarily.[18] In the course of the ensuing proceeding, the occupant of the property has various remedies to protect him against special hardships,[19] and, instead of the proceeding ending in an eviction of the reluctant occupant, the new owner may find himself as the court-appointed landlord of the occupant.[20]

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[13] Gesetz zur Begrenzung der mit Finanzinvestitionen verbundenden Risiken, Aug. 12, 2008, BGBL. I at 1666.

[14] Koch, *supra* note 10.

[15] Zwangsversteigerungsgesetz, [ZVG], repromulgated May 20, 1898, REICHSGESETZBLATT 713, as amended.

[16] E. COHN, 1 MANUAL OF GERMAN LAW 210 (London, 1968).

[17] R. BÖTTCHER, GESETZ ÜBER DIE ZWANGSVERSTEIGERUNG UND ZWANGSVERWALTUNG 3 (München, 2005).

[18] ZVG § 93

[19] R. ZÖLLER ET AL., ZIVILPROZESSORDUNG 1979 (Köln, 2007); Bundesgerichtshof, decision of Nov. 24, 2005, *reprinted in* MONATSSCHRIFT FÜR DEUTSCHES RECHT 775 (2006).

[20] Recently, the newspapers reported on a case in Munich in which the purchaser at a forced auction could not attempt to evict the wife and two small children of the former owner, because the court might have deemed her to be suicidal, while considering the purchaser as less deserving of sympathy because he got the property at only two-thirds of its market value. Instead of taking possession of his new house, he is now receiving rental payments

Among the various protections of foreclosure law, section 765a of the Code of Civil Procedure occupies an important place. It allows the court to set aside permanently or temporarily a measure of execution that, while taking into consideration the interests of the creditor, would nevertheless constitute a hardship against the debtor that would violate German public policy. The courts will grant this relief when the coercive execution measure would cause serious harm to the physical or mental health of the affected person, create a potential for suicide, or make families with small children homeless. The application of the provision also has constitutional overtones.[21]

Other protective provisions allow the debtor to request a six-month delay;[22] allow a creditor to insist that a bid may not be accepted that is below seven-tenths of the value of the auctioned-off property,[23] if this amount does not lead to the satisfaction of the creditor; and require the court to reject the highest bidder if his bid is below 50 percent of the value of the property.[24] In such a case, a new auction would have to be held, and the occupant again would remain in possession until a high enough bid is made.

Most of these protections were introduced in 1979,[25] in the course of a reform that on the one hand streamlined the foreclosure proceedings while, on the other hand, increasing the social protection of the debtors,[26] and this development fitted in with judicially developed constitutional principles that insist on proportionality and fairness in foreclosure proceedings[27] over and above the already protective standards that governed the original enactment of the law.[28]

C. Recent Legal Developments

From 1979 through 2008, no further increases in debtor protection were legislated, until a law reform was enacted in August 2008 in response to the global problems that had resulted from the securitization of mortgages. The then enacted Risk Limitation Act[29] was a compromise between several bills, some of which would have interfered significantly with free market

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that a welfare agency is paying on behalf of the occupants. *See* Draussen, *vor der Tür*, SUEDDEUTSCHE ZEITUNG 26, Mar. 27, 2008, *available at* LEXIS/library NEWS/fileZeitng.

[21] As developed by case law, these emanate from the principles of due process and proportionality and the guarantee of property (the latter is employed to the benefit of the debtor). *See* ZÖLLER, *supra* note 19, at 1856.

[22] ZVG § 30a.

[23] ZVG § 74a.

[24] ZVG § 85a.

[25] Gesetz zur Änderung zwangsvollstreckungsrechtlicher Vorschriften, Jan. 2, 1979, BGBl. I at 127.

[26] A. Hornung, *Die Zwangsvollstreckungsnovelle 1979*, DER DEUTSCHE RECHTSPFLEGER 284 (1979).

[27] ZÖLLER, *supra* note 19, at 1856.

[28] R. STÖBER, ZWANGSVERSTEIGERUNGSGESETZ 3 (München, 1999).

[29] Gesetz zur Begrenzung der mit Finanzinvestitionen verbundenden Risken, Aug. 12, 2008, BGBl. I at 1666.

principles in order to protect owner occupants against unfair mortgages.[30] As enacted, the changes in mortgage and foreclosure law are moderate, and focus primarily on reigning in abusive practices.

In its enacted version, the Risk Limitation Act requires a six-month statutory notification period before the creditor can petition for foreclosure.[31] In addition, the standardized terms of the loan mortgage contract must point out that the bank has the right to sell the mortgage loan, otherwise a sale is prohibited. This requirement is a compromise from the demand of some proponents of the bill that banks which offer mortgages must offer contracts that guarantee that the loan would never be sold. Although this requirement was not enacted, market demand induced many banks to offer mortgages that they guarantee to hold until maturity of the loan. [32]

For loans that are close to termination unless they are renewed and for loans for which the bank can change the rate at a certain time, the bank must notify the debtor of its intentions three months before the relevant date. In addition, the law now provides that foreclosure proceedings can be commenced only after the debtor is in arrears with two loan payment and a total of 2.5 percent of the face value of the loan.[33] Prior to this restriction, a creditor could foreclose on a land charge, which had become the preferred instrument for granting mortgages, at the slightest irregularity, and in some instances a creditor who had acquired the mortgage could move to foreclose on it, even if the loan was performing. These loopholes have now been closed.[34]

II. Tax Treatment of Owner-Occupied Housing

German income tax law has never granted deductions for home-owner's mortgages. Until 1996, significant deductions were granted to purchasers and builders of family homes for nine years following acquisition or construction,[35] and additional deductions were granted to homeowners with children.[36] In 1996, these benefits were abolished and replaced by cash grants for lower- and middle-class home owners.[37]

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[30]Among the rejected more radical bills was a draft of the Federal Ministry of Justice that would have required all banks offering mortgages to also offer mortgages that cannot be sold. *See* Press Release, Bundesministerium der Justiz, *Mehr Sicherheit für Häuslebauer,* Jan. 23, 2008, *available at* http://www.bmj.bund.de/enid/4c8389c6a942cf71b20c517d4bc4f32e,8b7a7f706d635f6964092d0934393637093a0979656172092d0932303038093a096d6f6e7468092d093031093a095f7472636964092d0934393637/Pressestelle/Pressemitteilungen_58.html.

[31] CIVIL CODE § 1192, as amended. Formerly the Civil Code also required a six months waiting period, but it could be waived contractually. Now it is mandatory. *See supra* notes 10 – 12 and accompanying text.

[32] Koch, *supra* note 10.

[33] CIVIL CODE, § 498 para. 3, as in effect since Aug.19, 2008.

[34] CIVIL CODE, §§ 1192 and 1193, as in effect since Aug.19, 2008.

[35] Einkommensteuergesetz [EstG], in the repromulgated version of Aug. 8, 1961, and as in effect through April 28, 1997, § 10e. The provision was no longer applicable to new transactions after Dec. 31, 1995, but continued to operate as a transitional provision.

[36] EStG, as in effect through Dec. 27, 1996, § 34e.

[37] Eigenheimzulagengesetz [EigZulG] repromulgated March 26, 1997, BGBl. I at 734, as amended.

As in effect between in 2004 and 2005, these cash grants were given for eight years after purchase or construction deductions in the amount of one percent of the invested sum, up to a maximum amount of € 1,250 per year. Homeowners qualified if their annual income was below € 70,000 (then U.S. $ 91.000) for individuals and double the amount for couples. Since January 1, 2006, the cash grant for homeowners is no longer given for new investments, but earlier investments will continue to enjoy the subsidy until their scheduled termination after a maximum of eight years.[38]

A few federal subsidies are still being granted, among them, several opportunities to obtain subsidies for buildings savings contracts.[39] These are subsidized because they encourage potential home buyers to save for several years before building or buying a home.[40] Since August 1, 2008, tax credits or deductions for investments in the owner-occupied dwelling are also granted within the framework of a subsidy program that encourages individuals to save for their retirement.[41] Altogether, these subsidies aim to replace, to some extent, the cash grants for home ownership that were abolished in 2006.[42]

German homeowners, however, are still largely exempt from capital gains taxes. In Germany, the non-business capital gains of individuals are free from taxation, if they are long-term gains. For real estate, the qualifying period is ten years.[43] Therefore, a German taxpayer does not pay income tax when he sells his home (or any other real estate) after owning it for ten years or longer.

As of January 1, 2009, a reform of inheritance tax legislation exempts family homes from taxation under certain circumstances, while increasing the inheritance tax on real property that does not qualify for the exemptions.[44] Until 2006, German real property was generally subject to the inheritance tax, yet very low assessments of the value of real estate lowered the tax burden significantly. In 2006, the Federal Constitutional Court vitiated that regime as being unconstitutional.[45] The new legislation of 2009 taxes real estate at market values, but grants exemptions for family homes, under certain circumstances. According to the new rules, a German heir of an owner-occupied family dwelling is exempted from inheritance tax if the

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[38] EigZulG, § 9.

[39] Fünftes Vermögensbildungsgesetz, Mar. 4, 1994, BGBl I at 406, as amended, § 8; Eigenheimrentengesetz, Jul. 29, 2008, BGBl I at 1508, arts. 3 and 5.

[40] Gesetz über Bausparkassen, repromulgated Feb. 15, 1991, BGBl I at 454, as amended, *available at* http://www.gesetze-im-internet.de/bausparkg/BJNR020970972.html.

[41] Eigenheimrentengesetz, Aug. 1, 2008 BGBl. I at 1509.

[42] H. Nüssgens, *Selbst genutzte Wohnungsimmobilien werden in die Riester-Förderung einbezogen,* SOZIALE SICHERHEIT 259 (2008).

[43] Einkommensteuergesetz, repromulgated Oct. 19, 2002, BGBl. I at 4210, as amended, § 23, *available at* www.gesetze-im-internet.de/estg/BJNR010050934.html.

[44] Gesetz zur Reform des Erbschaftssteuer- und Bewertungsrechts, Dec. 31, 2008, BGBl. I at 3018.

[45] Bundesverfassungsgericht, Nov. 7, 2006, docket number 1 BvL 10/06, *available at* http://www.bundesverfassungsgericht.de/entscheidungen/2006/11.

decedent was his spouse, parent, or grandparent. Yet the exemption applies only if the heir lives in the house for ten years, and, for children and grandchildren, only 200 square meters (2,150 square feet) of a single home or condominium are exempted. [46]

III. Housing Finance Systems

Germany does not have any housing finance systems that are sponsored or chartered by the government to provide liquidity on housing markets through the buying-up of mortgage loans, such as Fannie May[47] or Freddie Mac,[48] nor does it have any agencies supervising such systems that could be compared to the U.S. Federal Housing Administration.[49] Moreover, Germany has no programs comparable to the VA mortgages instituted by the Service Man's Readjustment Act of 1944.[50]

German banks are generally tightly supervised by a federal agency that supervises all financial services providers.[51] The securitization of mortgages, however, is not prevented by that agency. To date, German asset-backed mortgages have not posed a problem, because subprime mortgages are virtually non-existent.[52]

The German subsidies that are granted by federal statute are administered by the tax authorities.[53] In addition, the states and local communities may have their own subsidy programs.[54] These are administered by the local authorities in cooperation with local banks. These programs provide loans at subsidized interest rates for home purchases or improvements. Preferences for young families are often employed, as are income limits and limits on the size of the subsidized housing. In Bavaria, for instance, a subsidized condominium for a couple may not exceed 75 square meters (807 square feet), and a single dwelling 100 square meters (1076 square feet); for a family of four the limits are 105 square meters (1130 square feet) for a condominium and 130 square meters (1400 square feet) for a single dwelling.[55]

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[46] Erbschaftssteuer- und Schnkungsgesetz, Dec. 31, 2008, BGBl. I at 3018, § 13.

[47] *See* the Fannie Mae website, http://www.fanniemae.com/aboutfm/index.jhtml?p=About+Fannie+Mae.

[48] *See* the Freddie Mac website, http://www.freddiemac.com/corporate/company_profile/our_mission/.

[49] *See* the U.S. Department of Housing and Urban Development, Federal Housing Administration, website, http://portal.hud.gov/portal/page?_pageid=73,1&_dad=portal&_schema=PORTAL.

[50] 38 U.S.C. § 701 (1944).

[51] BAFIN Bundesanstalt für Finanzdienstleistungsaufsicht, at http://www.bafin.de/.

[52] Koch, *supra* note 10.

[53] EigZulG § 15.

[54] For Munich, *see* GEFÖRDERTER WOHUNUNGSBAU IN MÜNCHEN (Aug. 2008), *available at* http://74.125.47.132/search?q=cache:Y9QFh2OQySEJ:www.muenchen.de/cms/prod2/mde/_de/rubriken/Rathaus/75_plan/06_stadtsanierung/pdf/mbt_e_vi.pdf+gef%C3%B6rdeter+Zinssatz&cd=5&hl=en&ct=clnk&gl=us&lr=lang_de (last visited Mar. 14, 2009).

[55] *Id.*

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ITALY

HOUSING FINANCE LEGISLATION

Executive Summary

Mortgages are regulated under the Italian Civil Code, which provides for the expropriation of property by the creditor. Italian tax law provides for credits for mortgage interest payments, with limits on the credits of varying amounts, depending on the type of real property involved and the date the mortgage was established. Capital gains on the sale of owner-occupied houses are tax exempt. The Italian government plays only a very small role in the housing finance market.[1]

I. Foreclosure

Italy's Civil Code was initially enacted by Royal Decree No. 262 of October 16, 1942. It contains provisions on mortgages in Book Six, on Protection of Rights.[2] It states in article 2802 that a "mortgage gives the creditor a right to expropriate the property made liable to secure his claim, even against a third person transferee, and preference in being paid from the proceeds of the expropriation."[3] Although the Code does not detail procedures for foreclosure, the Banca d'Italia has published a study stating that recovery procedures are "long and costly" and estimating that the process may take five to seven years from the time someone defaults on a mortgage to the final settlement of the case.[4]

II. Tax Treatment of Owner-Occupied Housing

Individual income taxes in Italy are governed by Presidential Decree 017 of December 22, 1986.[5] Mortgage interest and other expenses connected with home ownership are eligible for a tax credit of up to 19 percent for any EU resident or an Italian permanent establishment of a non-EU resident. These credits are subject to maximum limits, some of which apply specifically to owner-occupied dwellings:

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[1] Note that as the Law Library does not have an Italian legal specialist on staff, this report was prepared based on available, English-language materials.

[2] Royal Decree No. 262, *translated in* MARIO BELTRAMO ET AL., THE ITALIAN CIVIL CODE AND COMPLEMENTARY LEGISLATION (Oceana, June 2008-).

[3] *Id*. at 39 (translating Royal Decree No. 262, Book 6).

[4] G. GOBBI, HOUSING FINANCE IN ITALY 1 (Banca d'Italia, 2005) (Bank for International Settlements Working Group report), *available at* http://www.bis.org/publ/ wgpapers/cgfs26gobbi.pdf.

[5] *See* Carlo Galli, *Italy, in* 2 TAXATION OF INDIVIDUALS IN EUROPE 7 (Catherine S. Bobbett, ed., July 2008).

- a limit of €4,000[6] on the credit for interest on mortgages of owner-occupied housing;
- a limit of €2,065 on the credit for interest on mortgages established before January 1, 1993, for non-owner occupied dwellings;
- a limit of €2,065.93 on the credit for interest on mortgages established before January 1, 1991, for all other buildings;
- a limit of €2,582.28 on the credit for interest on mortgages established before January 1, 1998, for owner-occupied housing; and
- a limit of €2,582.28 on the credit for interest on mortgages established in 1997 for the refurbishment of any real property.[7]

An additional tax credit may be available for the cost of refurbishing real estate, up to a ceiling on those costs of €36,000 for each property. The credit is equal to 36 percent of the expenses, and the credit must be taken over a period of either five or ten years.[8]

Capital gains from the sale of land or buildings are generally subject to taxation. If the capital gains that would be taxed are from the sale of a residential building that is the primary home of the seller or his or her family, however, those gains are not taxed. Capital gains on properties acquired by inheritance or also exempt from taxation.[9]

III. Housing Finance Systems

As reported in a 2001 census, about 71 percent of Italian households are dwelling in spaces they own, whether these are single-family houses or apartments.[10] According to a 2002 survey done by the Banca d'Italia, however, only about 10 percent of households had loans from banks for house purchases.[11] Of the mortgage loans issued by banks as of 2005, the majority were loans at variable rates, to be renegotiated annually. The government plays a very small role in the housing finance market; again as of 2005, they subsidized the interest rate payments for less than two percent of household mortgages.[12] As of 2004, the Urban Institute reported that Italy was developing a system of private mortgage insurance.[13]

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[6] 1 Euro = 1.29745 U.S. dollars as of March 16, 2009.

[7] Galli, *supra* note 5, at 33.

[8] *Id.*

[9] *Id.* at 27.

[10] GOBBI, *supra* note 4.

[11] *Id*. at 2.

[12] *Id*. at 1.

[13] Sally Merrill, *Expanding Lending Downmarket: The Role of Mortgage Guarantee Insurance*, Dec. 2004 (Urban Institute PowerPoint presentation), *available at* http://www.nextbillion.net/files/Track%207-Merril-THE%20ROLE%20OF%20MORTGAGE%20 GUARANTEE%20INSURANCE.ppt#7.

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JAPAN

HOUSING FINANCE LEGISLATION

Executive Summary

Japan's foreclosure laws have been amended several times since the "bubble economy" collapsed around 1990. Foreclosure procedures were sometimes disturbed by groups of gangs who prolonged the process or made foreclosures ineffective. In 2008, approximately 78 percent of the civil executions against real property were completed within a year. The foreclosure process requires a court order, but if all parties, including the second mortgage holder, if any, agree, the secured property can be sold on the open market, outside of the court procedure. Japan has a housing loan tax deduction and a capital gain tax deduction for houses. There has been a recent, significant change in the mortgage market in Japan. In 2007, the government-supported housing agency, the Government Housing Loan Corporation (GHLC) was replaced by the Japan Housing Finance Agency (JHFA). While the GHLC provided its own loans to households via banks and other loan originators, the JHFA does not usually provide loans directly to households. Some workers can arrange housing loans by using the Zaikei [asset forming] Housing Saving System. In addition, the municipal government may supplement housing loans.

I. Foreclosure Law

1979 Civil Execution Law

The 1898 Auction Law[1] was Japan's first modern foreclosure law that became effective.[2] Although the sale of a debtor's property for unsecured debt was provided for in the Auction Law, provisions for the execution of the foreclosure of a debtor's property were provided for in the Civil Procedure Law. The Auction Law did not require detailed disclosure regarding the auctioned house. As a result, buyers were limited to brokers, who were able to obtain the information. Live auctions were the only method of sale provided for under the Auction Law, which allowed bid rigging and threats against other bidders to easily occur.[3] In order to rationalize and integrate both procedures and increase the number of possible buyers, the Civil

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[1] Keibai hō [Auction Law], Law No. 15 of 1898.

[2] Hideo Saito, Keibai hō [Auction Law] *in* KEIBAI HŌ KAISHA KŌSEI HŌ [AUCTION LAW CORPORATION RESTRUCTURE LAW], 8-9 (1960).

[3] Keibai seido kenkyū kai [Foreclosure System Research Group], Keibai seido kenkyū kai hōkokusho [Foreclosure System Research Group Report], 6 (March 2008), available at http://www.moj.go.jp/MINJI/minji148-mokuji.pdf.

Execution Law[4] was enacted in 1979. The Auction Law was abolished when the new law became effective in 1980. In addition, the Civil Code,[5] Book II, contained a chapter on mortgages, with provisions that affect foreclosure.

Collapse of Bubble Economy and Prolonged Foreclosure Problem

After Japan's "bubble economy" collapsed in late 1980s, "the Nikkei stock index declined by more than 70%, and commercial land prices in large cities fell 82% from their peak, creating stockpiles of non-performing loans."[6] However, during that time, "the mortgage market was comparatively stable."[7] Also, the falling home prices were not a deflation trigger because "it was and is normally difficult for homeowners to realize gains from land appreciation. Moreover, individual borrowers were less overextended, because, at the time, Japanese banks didn't offer home equity loans or other risky financing."[8] However, non-performing loan problems plagued the Japanese economy. In the foreclosure area, the disturbance of foreclosures by gangs, like the *yakuza*, delayed execution on non-performing loans.[9] The gangs abused the measures designed to protect home owners and renters and/or implicitly threatened creditors and/or possible buyers in order to get money from creditors or to obtain the houses for low prices.

Amendments on Civil Execution Law after the Bubble Economy

The Civil Execution Law and the Civil Code have been amended several times to make Japanese foreclosure procedures more flexible, smoother, and faster. In 1996, in order to prevent actions to reduce the price of a seized property by a debtor or others, the injunction order for preservation was strengthened.[10] In 1998, a provision that allows a court to reject meritless objections against the execution quickly was inserted. Also, after the first auction was unsuccessful, if the creditor set a minimum price that he will purchase the property for if there is no bidder in a future auction, the creditor was now enabled to request an injunction order to prevent actions to reduce the price of a seized property by a debtor or others. In addition, the executer became entitled to request copies of materials regarding the property tax on the

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[4] Minji shikkō hō [Civil Execution Law], Law No. 4 of 1979.

[5] Minpō [Civil Code], Law No. 89 of 1896, *as amended*.

[6] Naoko Nemoto, Battle Over Japan's Mortgage Market Raises Default Risks, GLOBAL FIXED INCOME RESEARCH, 1 (Sept 2005), *available at* http://www2.standardandpoors.com/spf/pdf/fixedincome/09-16-05_BattleOverJapan.pdf.

[7] *Id*. at 1. The reasons for the relatively stable mortgage market were listed in the next page of the document. *Id*, at 2.

[8] *Id*. at 3.

[9] Kinyū hanzaiteki kōi kenkyū kai [Financial Criminal Acts Study Group], *Heisei kinyū kiki to han shakai teki seiryoku [Heisei Financial Crisis and Anti-Social Powers]*, 7 YOKIN HOKEN KENKYŪ [DEPOSIT INSURANCE STUDY], 45, 46 (Nov. 2006), *available at* http://www.dic.go.jp/kenkyu/2006/7-4.pdf; and Foreclosure System Research Group, *supra* note 3, at 7.

[10] The Civil Execution Law, Law No. 4 of 1979, *as amended* by Law No. 108 of 1996, art. 55. ARITOSHI FUKUNAGA, MINJI SHIKKŌ HŌ MINJI HOZEN HŌ [CIVIL EXECUTION LAW CIVIL PRESERVATION LAW], 15 (2007).

foreclosed property from the municipal government and all necessary information from utility companies.[11] Another amendment in the same year enabled the Deposit Insurance Corporation (DIC), the Housing Finance Management Corporation, and the Resolution and Collection Bank to skip the evaluation of foreclosed properties in order to speed up the procedure in case one of the institutions has already obtained a detailed report on the properties.[12] In 2003, there was a fairly significant amendment to the Civil Code and the Civil Execution Law.[13] The creditors became entitled to receive the rent from the property after the default. The system that could force a creditor to buy the secured property for ten percent more than the price the owner offered was abolished. The injunction order for preservation was strengthened again. The preview system was created. Prior to this amendment, possible buyers were not allowed to internally inspect the house.[14] In 2004, the minimum price system of the auction was changed to the standard price system. The minimum possible bidding price is twenty percent less than the standard price.[15]

<u>Overview of Foreclosure System in Japan</u>

The following is a brief overview of the foreclosure system in Japan. While a house and the land the house sits on can be owned and traded separately in Japan, the following overview is based on the situation where the owner of the house and the owner of the land are the same.

Foreclosure Through Court Procedure

In order to foreclose on a debtor's house and collect money, a creditor must usually obtain a court order. When the court decides whether a house is to be foreclosed on, the court examines all available documents; a hearing is not necessarily held.[16] When the court decides to commence the foreclosure, the court declares the seizure of the house. A copy of the decision is sent to the debtor and to the owner of the house, if the owner is different from the debtor. If they have an objection, either or both of them can file an objection.[17] Alternatively, a debtor or an owner of the house can sue a mortgage holder to confirm non-existence of the mortgage,[18] and

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[11] The Civil Execution Law, Law No. 4 of 1979, *as amended* by Law No.128 of 1998, art. 10, para. 5, art. 57, paras. 4 and 5, and art 68-2. Fukunaga, *supra* note 10.

[12] The Civil Execution Law, Law No. 4 of 1979, *as amended* by Law No.129 of 1998, arts. 2, 3, and 4.

[13] Tanpo bukken oyobi minji shikkō seido no kaizen no tame no minpō tō no ichibu o kaisei suru hōritsu [Law To Amend Parts of the Civil Codes and Other Laws to Improve Foreclosure and Civil Execution], Law No. 134 of 2003.

[14] Fukunaga, *supra* note 10.

[15] Minji kankei tetuduki no kaizen no tame no minji soshō hō tō no ichibu o kaisei suru hōritsu [Law To Amend Parts of Civil Procedure Code and Other Laws To Improve Civil Procedure], Law No. 152 of 2004. Fukunaga, *supra* note 10, at 16.

[16] Civil Execution Law, Law No. 4 of 1979, *as amended by* Law No. 95 of 2007, arts. 4 and 5.

[17] *Id*. art. 182.

[18] *Id*. art. 183.

file for a preliminary injunction to stop the foreclosure.[19] When a debtor or an owner cannot stop the foreclosure, the house is listed for sale at auction. After the seizure, other creditors can report the amounts owed to them and demand dividends. The court appoints and orders an executor to make and submit a report of the conditions of the house, and selects an evaluator and orders him to evaluate the value of the house.[20] The base price of the house for the auction is 80 percent or more of the evaluated value.[21] A court clerk prepares a document containing the specifications of the house. The specification, the condition report, and evaluation report are made available to the public prior to the auction.[22] Many courts maintain internet sites for these publications. The court that commenced the foreclosure must order the executer to have a preview opportunity for possible buyers. The possible buyers must register for the preview in advance. The auction may be conducted in the form of a live auction or a silent auction. If the house is not sold at the auction, the executer can sell the house in other ways, e.g. through advertising the house as a realtor would.[23] A buyer of a foreclosed house obtains the property when he makes complete payment.

In 1996, the amount of time to complete the civil execution of real property (from the initial filing, to court order, to the sale of the house) was as follows:

- 19.7 percent for less than six month;
- 22.4 percent for six months to one year;
- 30.7 percent for one to two years; and,
- 27.2 percent for more than two years.

The time to complete a civil execution has been shortened after amendments to the relevant laws. In 2006, the amount of time to complete a civil execution of real property was as follows:

- 24.2 percent for less than six month;
- 54.1 percent for six months to one year;
- 16.3 percent for one to two years; and,
- 5.4 percent for more than two years.[24]

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[19] Minji hozen hō [Injunction Law], Law No. 89 of 1989, *as amended*, art. 23, para. 2.

[20] Civil Execution Law, Law No. 4 of 1979, *as amended*, art. 58, para. 1.

[21] *Id*. art. 60.

[22] *Id*. art. 62.

[23] Civil Execution Law, Law No. 4 of 1979, *as amended*, art. 51.

[24] Foreclosure System Research Group, Fudōsan shikkō jiken no shori kikan no suii [Changes of Processing Time of Real Estate Execution cases], attachment 4 of *supra* note 3.

Sales of Secured Houses Outside of Court Procedures

When a creditor and a debtor have an agreement that allows a creditor to sell or own a house without resort to the civil execution procedure, the procedure prescribed in the Civil Execution Law can be skipped. In this instance, the creditor or the debtor can sell the secured property on the open market. [25]

II. Tax Treatment

In this section, only national taxes are explained. The followings are summaries of the laws and there are more details in the tax laws.

A. Housing Loan Tax Deduction

Japan has not had a permanent housing loan tax deduction system in the Income Tax Law,[26] but has had limited-time, special housing tax deduction measures since 1972.[27] The 1999 Tax Special Measures Law amendment[28] reformed the 1972 housing loan deduction measure. The 1972 measure applied only to loans for buildings, but the 1999 measure included loans for lands if the loans were for both lands and the houses on them.[29] The deduction period was extended from six year to fifteen years.[30] In 2001, the period was shortened to ten years.[31] In 2007, in addition to a ten year deduction period, a fifteen year deduction period was added as an alternative.[32] Other requirements were also relaxed. The housing loan tax deduction measure had been amended several times. In 2008, the summaries of the measures were as follows:

(1) New Purchase and Move-In During 2008

When a person whose annual income was 30 million yen [US$300,000] or less bought a house and moved into the house during 2008, with a loan of 20 million yen [US$200,000] or more, which term was more than ten years, the person can deduct one percent of the amount of

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[25] Minpō [Civil Code], Law No. 89 of 1896, *as amended*, art. 137.

[26] Shotokusei hō [Income Tax Law], Law No. 33 of 1965, *as amended.*

[27] Sozei tokubetsu sochi hō [Tax Special Measures Law], Law. No. 26 of 1957, art. 41, *amended by* Law No. 14 of 1972.

[28] Sozei tokubetsu sochi hō oyobi hanshin awaji daishinsai no hisaisha tō ni kakaru kokuzei kankei hōritsu no rinji tokurei hōritsu no ichibu o kaisei suru hōritsu [Law To Amend Tax Special Measures Law and Hanshin Awaji Earthquake Emergency Tax Treatment Law], Law No. 9 of 1999.

[29] Tax Special Measures Law, Law No. 26 of 1957, art. 41, para. 1, *amended by* Law No. 9 of 1999.

[30] *Id*.

[31] Sozei tokubetsu sochi hō no ichibu o kaisei suru hōritsu [Law To Amend Tax Special Measures Law], Law No. 7 of 2001.

[32] Tax Special Measures Law, Law. No. 26 of 1957, art. 41, para. 3, *amended by* Law No. 6 of 2007.

the loan, up to the 200,000 yen[33] at the end of the year for six years. From the seventh to tenth years, 0.5 percent of the amount of the loan, up to 200,000 yen at the end of the year can be deducted. Alternatively, the person can choose the deduction over fifteen years. In such cases, the person can deduct 0.6 percent of the amount of the loan at the year end, up to 20 million yen for first ten years and 0.4 percent for following five years.

(2) Previous Purchase and Move-In

The deduction amount depends on the year of the move-in. It may be that the most generous deduction applies where the person purchased a house and moved in during 1999 through the first half of 2001. If all other requirements are satisfied, such person can deduct one percent of up to 50 million yen [US$500,000] loan from his annual income for first five years, 0.75 percent during the sixth through tenth years, and 0.5 percent during eleventh through fifteenth years.

The current measures, the 1999 measures and their subsequent modifications, were effective until the end of 2008. In 2009, a bill was submitted by the government,[34] which extends the measures for five years. Under the bill, if other requirements are met, a person who buys a house and moves into it during 2009 or 2010 can deduct one percent of up to a 50 million yen [US$ 500,000] housing loan from his annual income. The amount of deduction will decline every year for the person who buys a house in 2011, 2012, or 2013.

B. Capital Gains Tax

When a person sells a house for an amount that is more than the purchase price and purchase costs, a capital gains tax is imposed. If a person sells a house for an amount that is lower than the purchase price and purchase costs, he can deduct the loss from his taxable income.

As of 2008, for the sales of an owner-occupied house, a capital gains tax is imposed separately from income tax. Because of the special deduction for capital gains from sales of an owner-occupied house, such capital gain of up to 30 million yen [US$ 300,000] is not taxed.[35] The capital gains tax rate for a house owned for more than ten years as of January 1 of the sales year is ten percent for the first 60 million yen [US$ 60,000] of the capital gains, and fifteen percent for amounts above that amount.[36] The tax rate for a house owned for more than five years is 15 percent;[37] and the rate for a house owned for less than five years is thirty percent.[38]

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[33] This means the maximum deduction amount was 200,000 yen [US$ 2,000].

[34] Kakuhō [Cabinet Bill] No. 6 of 171st Diet, *available at* House of Representative's website http://www.shugiin.go.jp/itdb_gian.nsf/html/gian/honbun/g17105006.htm. The Bill is awaiting enactment.

[35] Tax Special Measures Law, Law No. 26 of 1957, *amended by* Law No. 23 of 2008, art. 35, para. 1.

[36] *Id*. art. 31-3.

[37] *Id*. art. 31, para. 1.

[38] *Id*. art. 32, para. 1.

In addition, there is a system that allows a person who sells a house that was bought ten or more years before and buys a house to occupy to defer capital gains tax until next time he sells the new house and buys another house.[39]

When a person sells a house for an amount that is lower than the purchase price and purchase costs, he can deduct the loss from his annual income and defer the loss that exceeds his annual income.[40]

III. Housing Finance

Recently, there was a significant change in the mortgage market in Japan. In 2007, a government-supported housing agency, the Government Housing Loan Corporation (GHLC) was replaced by the Japan Housing Finance Agency (JHFA).[41]

During the middle of an unprecedented housing shortage after the Second World War, the General Headquarters of the Allied Powers that occupied Japan instructed the Japanese government to establish a special financial institution to finance land development and housing, and to supplement private banks as a part of the reform of the financial system.[42] The government established the GHLC in 1950. Until the 1980s, private financial institutions had barely enough funds to provide to industries for plant and equipments investments and did not provide sufficient housing loans. The GHLC had been the main provider of long-term fixed rate mortgages. As of 1987, a quarter of the houses that were built after the WWII were financed by the GHLC.[43] By 2005, the rate of new houses built rose from one-quarter to thirty percent.[44] In 1993, the Third Special Commission for Administrative Reform of the government reported that public financial institutions should seek to take an adequate role that would supplement the work of private financial institutions.[45] After Japan's financial "Big Bang" between 1996 and 2001,[46] private financial institutions became more aggressive in providing housing loans.[47] In 2005, the Diet (the Japanese Parliament) enacted a law which replaced the GHLC with the

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[39] *Id*. art. 36-2.

[40] *Id*. art. 41-5.

[41] Dokuritsu gyōsei hōjin Jūtaku kin-yū shien kikō hō [JHFA Law], Law No. 82 of 2005, annexed provisions art. 2.

[42] GHLC, JŪTAKU KINYŪ KŌJO 50 NEN SHI [50 YEARS HISTORY OF GHLC], 3 (2000).

[43] *Id*. at 39.

[44] Representative Issei Kitagawa's statement, KOKUDO KŌTSŪ IINKAI GIROKU [MINUTES OF LAND AND TRANSPORTATION COMMITTEE], HOUSE OF COUNCILLORS, 162nd Diet Session No. 25, 1 (June 28, 2005).

[45] GHLC, *supra* note 43, at 53.

[46] Financial Services Agency, About the Financial System Reform, *available at* http://www.fsa.go.jp/p_mof/english/big-bang/ebb1.htm (last visited Mar. 12, 2009).

[47] Statement of Shigetaro Yamamoto, Director of Housing, Ministry of Land, Infrastructure and Transportation, MINUTES OF LAND AND TRANSPORTATION COMMITTEE, HOUSE OF COUNCILLORS, *supra* note 45, at 2.

JHFA.[48] Where the GHLC provided its own loans to households via banks and other loan originators,[49] the JHFA does not provide loans directly to households, except in special situations, such as houses rebuilt after a disaster.[50] The JHFA engages in the securitization business for housing loan products with a long-term, fixed interest rate, so that private financial institutions can provide these loans smoothly.[51] Financial institutions that sell these housing loans are allowed to set their fee portions of interest rates at their own discretion.

There are two other types of public housing finance systems. One is the Zaikei [asset forming] Housing Saving system. The Zaikei system was established in 1971[52] to assist workers with asset forming, modeling West Germany's system.[53] At this time, Japan's economy had become the third largest in the world and workers' wages were getting higher and more improved. However, workers did not have many assets, such as decent housing, bank deposits, and stocks, as compared to workers in the United States and Western Europe.[54] The measures related to the Zaikei system have been changed several times.[55] In 1975, housing loan measures were introduced.[56] Currently, under the system, workers who are employed by firms that participate in the system can make regular deposits to a participating financial institution for at least five years.[57] The deposit is done by way of the employer withdrawing a set amount of money from the worker's salary and sending it to the financial institution.[58] Tax on the interest of the deposit is exempted.[59] The deposit can be used only for acquisition of a house. An eligible employee can borrow up to ten times the amount of the deposit (up to 40 million yen [US$ 400,000]).[60] A public corporation, the Employment and Human Resources Development

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[48] JHFA Law, Law No. 82 of 2005 (July 6, 2005).

[49] Jūtaku kin-yū kōkō hō [GHLC Law], Law No. 156 of 1950, *as amended*, art. 17.

[50] JHFA Law, Law No. 82 of 2005, *as amended*, art. 13.

[51] *Id*.

[52] Kinrōsha zaisan keisei sokushin hō [Law to Promote Workers' Asset Forming], Law No. 92 of 1971.

[53] MASAKATSU FUJINAWA, KINRŌSHA ZAISAN KEISEI SOKUSHIN HŌ HAYA WAKARI [QUICK UNDERSTANDING OF LAW TO PROMOTE WORKERS' ASSET FORMING], 20 (1972).

[54] *Id*. at 3.

[55] TOKIO NANASE, KINRŌSHA ZAISAN KEISEI SOKUSHIN HŌ NO KAISETSU [COMMENTARIES ON LAW TO PROMOTE WORKERS' ASSET FORMING], Preface (1997).

[56] Kinrōsha zaisan keisei sokushin hō no ichibu o kaisei suru hōritsu [Law To Amend A Part of Law To Promote Workers' Asset Forming], Law No. 42 of 1975.

[57] Law to Promote Workers' Asset Forming, Law No. 92 of 1971, *as amended*, art. 6, para. 4.

[58] *Id*.

[59] Tax Special Measures Law, Law No. 26 of 1957, *amended by* Law No. 23 of 2008, art.4-2.

[60] Law to Promote Workers' Asset Forming, Law No. 92 of 1971, *as amended*, art. 9, para. 1, and Kinrōsha zaisan keisei sokushin hō sekō rei [Enforcement Order of Law to Promote Workers' Asset Forming], Order No. 332 of 1971, *as amended*, art. 33.

Organization of Japan (EHRD),[61] borrows money from participating financial institutions,[62] and lends the money to the employers.[63] The employer then makes a loan contract with the employee. There are certain physical requirements for the house purchased.

The other type of public housing finance system is municipal government housing loans. For example, Kyoto Prefecture lends up to 7 million yen [US$ 70,000] through participating financial institutions to residents with limited income who have a loan that is backed by JHFA.[64] There are many municipal governments that pay a part of housing loan interest. For example, in the 2008 fiscal year (until March 31, 2009), Arakawa City of Tokyo has a system to pay 0.9 percent of the annual interest of a resident's housing loan to a participating financial institution that has a housing loan contract with a resident.[65]

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[61] The Organization does not have an English website. Its website in Japanese language is *at* http://www.ehdo.go.jp. Its Zaikei webpage is *at* http://www.ehdo.go.jp/zaikei/zaikei.html (last visited Mar. 12, 2009).

[62] Law to Promote Workers' Asset Forming, Law No. 92 of 1971, *as amended*, art. 11.

[63] *Id*.

[64] Kyoto Prefecture, Kyoto-fu jūtaku kensetsu shikin yūshi seido ippan jūtaku [Kyoto Prefecture House Building Fund Loan System], http://www.pref.kyoto.jp/jutaku/loan-kousha1.html (last visited Mar. 12, 2009).

[65] Arakawa City, Jūtaku shikin yūshi assen seido [Housing Loan Assistance System], *available at* http://www.city.arakawa.tokyo.jp/a001/b007/d04000059.html (May 16, 2008).