

A Cure Demands Drive

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One year before the financial crisis started, a thesis printed in black and white was handed to the University of Copenhagen. And should the housing and financial markets once again rise, it would take drive and courage, the author, Jens Kjaer Sorensen, of the thesis concludes.

But it is tough going against the wind. Denmark was the first European country in recession; we have the highest debt linked to real estate, one of the wildest expansions in construction of new houses and a fragmented financial sector.

That is how clear the message is from Jens Kjaer Sorensen, an equity trader in a greater Nordic bank, who, in his Masters thesis, analysed 23 housing bubbles.

A longer period with downturn and further decreases on real estate is very hard to prevent, but we should not give up.

There exists a number of specific, potential actions to do, Jens Kjaer Sorensen says, but it is most reasonable to ride through the worst of the pain, before any greater adjustments are made.

Create an exchange for real estate prices

If Jens Kjaer Sorensen was asked to dive into the toolbox, he would take use of several tools, which would limit the risk of new real estate bubbles and financial crisis.

Futures-contracts for real estate should be developed on even terms with equities, the economist suggests. It would create a market, in which you can trade and adjust risks related to further price decreases – a sort of insurance.

"As an individual you will get a tradable good, which can be priced directly in the market. In that way it would be possible to not only focus on equities, but focus also on the whole investment spectra and look at real estate, equities, bonds, commodities and currencies. It is possible to get a fairly risk neutral portfolio," Jens Kjaer Sorensen says to borsen.dk.

Robert Shiller leads the way

The American economist Robert Shiller has experimented with a similar solution, which has led to the American real estate index named S&P/Case-Shiller Home Price Indices. But Shiller's idea is far from emptied. The Shiller-index is, according to Jens Kjaer Sorensen, not yet tradable and functions only in the US on 20 selected regions and in a combined national index.

Scaling up and adding higher quality long run is essential, such that a long term advice can be given, since real estate must be considered as a good with a long investment horizon, the Economist says.

Jens Kjaer Sorensen doesn't want to hit the Danish home owners. He suggests that regulation affecting the real estate market should be targeting people who speculate in the market and not the ordinary citizen.

"People should be able to live in their normal house. But speculation in real estate?— why not tax real estate investment on equal terms as capital gains from other investment objects?. From abroad we know that this possibility fully exists," demands Jens Kjaer Sorensen.

A farewell to interest rate only loans

As a possible protection against the development of future crisis, the equity trader also suggest to adjust the length of the amortization period for home buyers upward during downturns and downward during upturns. If such is implemented the problems won't escalate – and not least to terminate the possibility for interest only loans.

"The possibility to obtain interest only loans should be terminated. Private individuals do not understand the underlying risk profile. In the short run, such a termination will have severe negative effects and should only be done during an upturn," the equity trader points out.

Jens Kjaer Sorensen says that what is missing is both a national and international responsible organisation, which independently will comment on the housing market and take the necessary action, such that the real estate market does not enter a new storm. The current financial crisis clearly shows lack of control and regulation when it was most needed.