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Stimulating the Development of Residential Development through Mortgage Lending

Abstract

The article is devoted to stimulating the development of housing construction through mortgage lending. The *purpose* of the article is to determine the role of mortgage lending in the development of the housing sector, in particular through its impact on supply and demand in the real estate market and pricing in this sector. In the course of the research, data analysis, correlation analysis, and methods of forecasting economic trends were used. Graphical methods were also used to provide a clear understanding of how changes in the mortgage market affect the development of the real estate sector. The *results* of the study show that mortgage lending is a key element in stimulating the development of the housing sector, as it not only directly facilitates access to finance for potential property buyers, but also indirectly affects the pricing and investment attractiveness of the housing sector. The paper shows that fluctuations in mortgage rates have a significant impact on the dynamics of supply and demand in the residential real estate market, as well as on price trends. In particular, rising mortgage rates tend to reduce demand for housing, as households expect better investment opportunities. There is also a strong correlation between mortgage rate increases and slower price growth. The expansion of the mortgage lending market and, consequently, a reduction in mortgage rates boosts supply in the real estate market. Nevertheless, it is found that such changes can have complex and ambiguous consequences, including the risks of market overheating and the formation of price "bubbles" that threaten the stability of the sector in the long run. In addition, the study found that mortgage lending facilitates the implementation of new construction projects and the expansion of the housing stock, which is an important factor in stimulating economic growth. At the same time, the analysis showed that the impact of mortgage rates on the real estate market depends on a wide range of factors, including the economic situation, central bank policy, consumer confidence and other macroeconomic indicators. The *practical significance* of the publication is to provide recommendations for the development of a balanced policy in the field of mortgage lending aimed at supporting the stable development of the housing sector and preventing potential destabilising factors in the real estate market.

Keywords

mortgage lending, housing sector, real estate market, pricing

JEL: F34, R32, R33

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DOI: <https://doi.org/10.30525/2500-946X/2024-2-2>**1 Introduction**

The development of residential construction is one of the key components of sustainable economic growth and social well-being in any country. This sector directly affects not only the level of housing conditions of the population, but also many other aspects of citizens' lives, including employment, mobility and social stability. Mortgage lending is one of the most effective tools to stimulate the development of housing construction, providing the general population with the opportunity to become homeowners and helping to attract investment in the sector.

Mortgage lending acts as a bridge between the needs of homebuyers and the ability of developers

to realise new projects, thereby meeting the demand in the property market. This not only helps people realise their dream of home ownership, but also stimulates economic activity through the involvement of the construction industry, job creation and the development of related economic sectors.

However, the role of mortgage lending in stimulating the development of residential construction is not clear and requires a careful analysis of the conditions under which this mechanism can be most effective, as well as the identification of potential risks and negative consequences that may accompany the growth of mortgage debt. Therefore, the consideration of the issue of stimulating the development of residential construction through

mortgage lending requires a comprehensive approach, taking into account both economic and social aspects.

The **purpose of the article** is to determine the role of mortgage lending in the development of the housing sector, in particular, through its impact on demand, supply in the real estate market and pricing in this sector. In order to achieve the objective of the study, the research will be carried out in the following sequence. In the first stage, factors influencing the impact of mortgages on the housing market will be identified. In the second stage, a statistical analysis will be carried out using graphical methods to show trends in the impact of the mortgage market and the residential property market. In the third stage, generalisations will be made about how mortgages influence the development of the housing market.

2 Research Materials and Methods

The issue of stimulating the development of housing through mortgage lending is reflected in a limited number of scientific works and publications. The research by Ermilova and Gryzunova (2021) makes a significant contribution to the understanding of financing mechanisms in the housing sector, especially in the context of globalisation processes. The authors analyse financing instruments using the specifics of the American market, which provides a comprehensive view of the current state and development opportunities for mortgage lending.

In addition to academic work, the study is supported by data from various sources, including analytical reports and market reviews, which highlight current trends and challenges in the mortgage sector. These sources provide quantitative data and expert assessments that facilitate a deeper understanding of the relationships between interest rates, lending conditions and the development of the housing sector.

However, despite the variety of existing expert and statistical studies and analytical materials, the literature lacks a systematic view of the issue of mortgage lending, which would include a systematic analysis of the factors influencing mortgage lending and construction development. Looking at the issue in a broader context, it can be said that the relevance and complexity of issues related to mortgage lending and its role in stimulating housing development require a comprehensive approach to analysis. The use of different methods of scientific research and analysis makes it possible to systematise the available information and provide well-founded recommendations for optimising policy in this area.

3 Results and Discussion

Mortgage lending plays a pivotal role in the development of the US housing market, as it

provides financing for home purchases, which is a key factor in ensuring housing affordability and stimulating the construction sector (Bank Wealth Management, 2024).

The direct impact of mortgages on the level of housing construction is manifested in the provision of access to credit, which allows buyers to finance the purchase of property and thereby supports the demand for new housing. The indirect impact of mortgages on the residential property market is seen through the influence of lending on house prices and the attractiveness of the sector as an investment. In particular, lower mortgage rates can lead to increased demand for housing, which in turn leads to rising house prices and encourages developers to start new projects. Conversely, higher mortgage rates can lead to a reduction in demand, slowing house price growth and reducing incentives for new construction.

Table 1 shows how mortgages affect the development of the housing sector.

Turning from a general analysis of the impact of mortgages on the development of the housing sector to the specifics, it is important to look at the quantitative data that illustrate this impact. Table 2 provides detailed statistics showing the relationship between mortgage rates and key housing market parameters, including housing prices, supply and demand. A careful analysis of mortgage rate fluctuations and their relationship to key indicators provides a deeper understanding of the trajectory of the housing sector, which facilitates the design of the regulatory framework and support measures.

The Pearson correlation coefficient is a statistical measure of the linear relationship between two variables. In the context of analysing the impact of mortgage rates on the housing market, this coefficient can be used to assess the degree of relationship between mortgage rates and housing demand. According to the data presented in Table 2 and illustrated in Figure 1, there is a negative correlation between these variables, which indicates that an increase in mortgage rates is associated with a decrease in housing demand.

In the context of the above analysis, rising mortgage rates increase the cost of borrowing, which in turn increases the financial burden on potential homebuyers. This reduces their ability to purchase property, thereby reducing demand for housing. The impact of high mortgage rates on housing demand may have long-term implications for the real estate market, as demand is one of the key drivers of market activity and pricing.

As higher mortgage rates lead to lower demand, the market may suffer the following consequences:

- Increased supply on the market – due to lower demand, there may be an accumulation of unsold housing units, which increases supply on the

TABLE 1 Factors influencing the impact of mortgages on the development of the housing sector

Impact factor	Impact type	Example
Impact on price	Direct	Since March 2023, the Federal Reserve has raised rates ten times, leading to higher 30-year fixed mortgage rates and thus higher house prices. High mortgage rates have led to higher monthly payments, adding up to 75,000 USD to the total cost of a 30-year loan.
Impact on the housing market (demand)	Indirect	The rise in mortgage rates increased the monthly borrowing costs of potential buyers, freezing activity in the housing market.
Impact on the housing market (supply)	Indirect	The rise in mortgage rates creates a lock-in effect, when, without a decent mortgage offer, customers reduce the number of housing offers, waiting for a more favourable time.
Impact on housing construction	Direct	Falling demand and rising lending costs led to a 7% decline in the number of new single-family homes.

Source: systematised by the author based on Jung (2023)

TABLE 2 The relationship between mortgage rates and housing prices, supply and demand

	Jan. 20	Jul. 20	Jan. 21	Jul. 21	Jan. 22	Jul. 22	Jan. 23	Jun. 23	Jan. 24	Pearson's coefficient
Mortgage rate, %	3,86	3,35	2,95	3,13	3,4	5,55	6,71	6,95	7,23	1,00
Sale price, thousand USD	290	330	330	380	375	410	380	450	400	0,69
Housing for sale, million	1,8	2	1,3	1,7	1,2	1,8	1,4	1,6	1,4	-0,14
Housing demand, %	20	30	34	57	42	48	22	39	25	-0,30

Source: compiled by the author based on data from Redfin (2024) and Bankrate (2024)

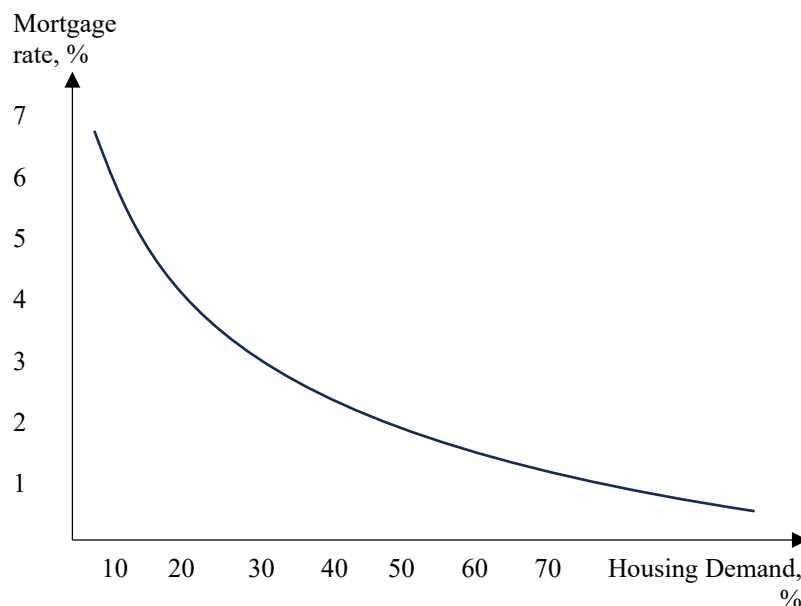


FIGURE 1 Mortgage rates and housing demand

Source: compiled by the author

market and could potentially lead to lower property prices in the long term.

- Reduced investment in new construction – lower demand may slow the pace of new construction as developers become less willing to take risks in an uncertain market.
- Reduced affordability of housing – while mortgage rates affect all market participants, buyers with limited financial resources are the most vulnerable to rising rates, which further complicates the problem of housing affordability for this segment of the population (Faster Capital, 2024).

One of the key patterns identified in the study is that rising mortgage rates are correlated with rising housing prices. This relationship is illustrated in Figure 2 and empirically confirmed by the Pearson correlation coefficient of 0.69.

This value indicates a moderately positive correlation, which means that as mortgage rates rise, residential property prices rise.

Rising mortgage rates increase the cost of borrowing, which may deter potential buyers from entering the market, leading to a decline in demand for housing. In a situation of declining demand,

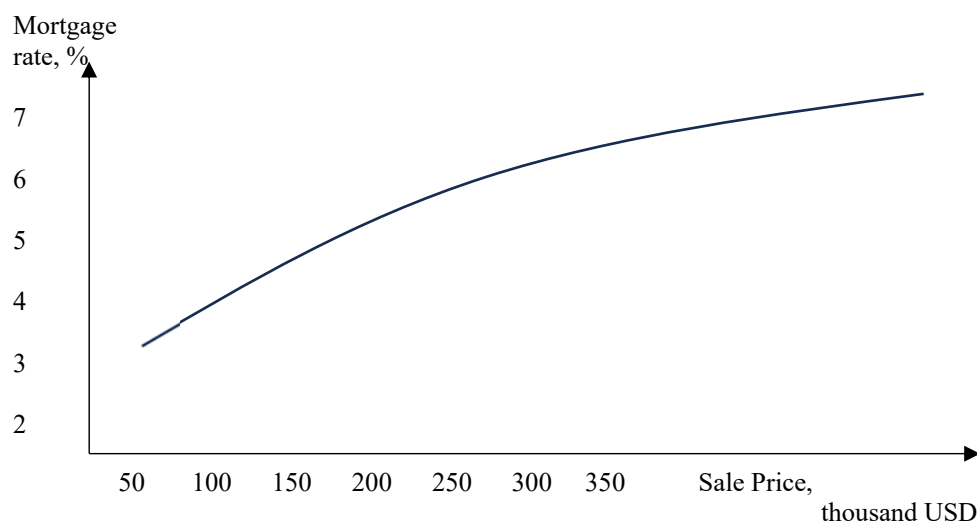


FIGURE 2 Mortgage rate and housing sale price

Source: compiled by the author

residential property prices may stabilise or even decline, which has a cascading effect on the entire sector. Conversely, low mortgage rates boost demand, increasing housing prices and encouraging the construction industry to undertake new projects. This leads to an increase in the supply of residential property, which in turn can affect market equilibrium.

Looking at the specific mechanisms through which mortgage rates affect the housing market, it is important to note the following:

- Housing affordability. Rising mortgage rates reduce the financial capacity of buyers, limiting their purchasing power and affecting the range of housing options available to them.
- Construction. The investment climate for developers is largely dependent on mortgage rates: low rates encourage the expansion of construction projects, while high rates may halt new construction plans due to lower demand.
- Investor behaviour. Mortgage rates have a direct impact on the profitability of real estate investments, affecting the incentives for investors to buy residential and commercial property.

Mortgage rates are therefore a fundamental factor shaping trends in the property market, affecting all aspects of the housing economy – from individual buyers to large construction corporations and investment funds. Careful observation and analysis of these changes is key to understanding current and future market trends.

The third important pattern identified in the study shows that there is an inverse relationship between mortgage interest rates and the number of property listings on the market. This relationship is confirmed by the negative value of the Pearson's coefficient, which, although not indicative of a high level of correlation (-0.14), nevertheless indicates

a certain degree of interconnection between these parameters, as shown graphically in Figure 3.

In light of this pattern, the housing market is experiencing a phenomenon known as the "lock-in effect". This phenomenon is the reluctance of homeowners to sell their properties due to rising mortgage rates, which makes it difficult to obtain favourable credit terms for the purchase of new housing. As a result, homeowners prefer not to sell, hoping to maintain their current favourable mortgage terms.

The locking effect can lead to the following consequences:

- Reduced supply of housing on the market: as fewer owners are willing to sell, the number of properties available for sale is decreasing, potentially making it more difficult for potential buyers to find a home.
- Rising real estate prices: limited supply in a context of stable or growing demand may lead to higher housing prices, making it less affordable for a wider range of buyers.
- Reduced market liquidity: the lockdown effect may lead to a reduction in the number of transactions in the real estate market, limiting market activity and reducing liquidity.

To mitigate the negative effects of the lock-in effect, strategic approaches and innovative solutions are needed to stimulate market activity and ensure greater flexibility in loan terms. This may include the development of refinancing programmes that allow homeowners to retain favourable loan terms even when moving to new housing, as well as encouraging the construction industry to increase the supply of affordable housing on the market (Porter, 2024).

Based on the analysis of the impact of mortgage lending on the development of the residential real

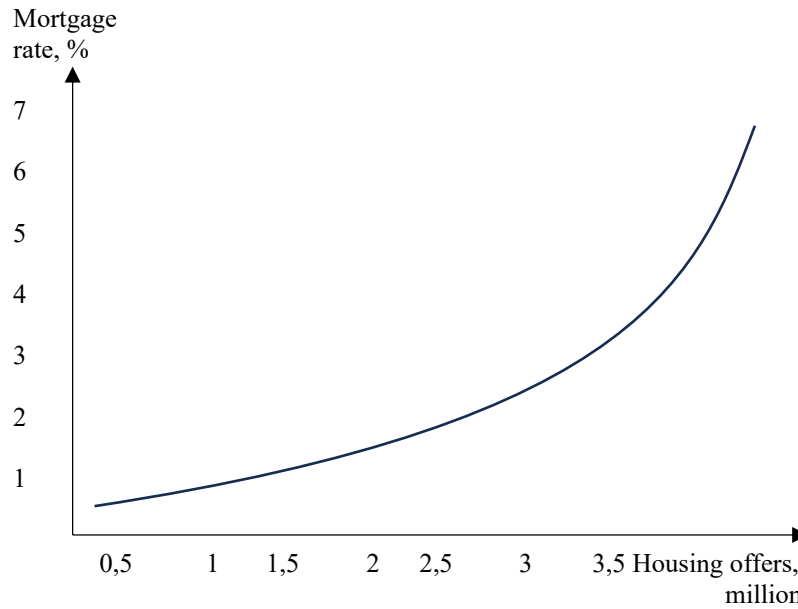


FIGURE 3 Mortgage rate and houses for sale (offers)

Source: compiled by the author

estate sector, several key conclusions can be drawn that illustrate the mechanisms for stimulating the development of this sector.

Mortgage lending is thus an important factor in stimulating residential property development, affecting all aspects of the market, from housing affordability to investment in new construction. However, it is not clear that a reduction in the mortgage rate is an unambiguously positive factor for the housing market, as it should theoretically make housing more affordable for a wider range of buyers. Research by Kohl S. (2018) shows that in OECD countries, an increase in homeownership

is possible even with moderate growth or stability in the level of mortgage debt relative to GDP.

A key finding is that a reduction in mortgage rates does not guarantee an increase in home ownership. Low interest rates can contribute to rising house prices by increasing the number of people looking to sell their property. In addition, "price bubbles" in the housing market, which can result from rapid growth in demand, can lead to economic crises and a reduction in homeownership, while leaving the debt burden unchanged (USA Mortgages, 2022).

Therefore, if policymakers wish to increase homeownership, they could consider alternative

TABLE 2 Impact of mortgage lending on the development of the residential property sector

Mortgage lending impact	Description
Affordable housing	Lower mortgage rates make housing more affordable for a wider range of buyers, increasing demand and stimulating market development. Higher mortgage rates limit purchasing power, which leads to lower demand for housing and slower development of the sector.
Real estate investments	Low mortgage rates stimulate the construction industry to implement new projects, as the growing demand for housing provides a high return on investment. An increase in mortgage rates may lead to a decrease in investment in new construction due to uncertainty about future demand.
Real estate market prices	The moderately positive correlation between mortgage rates and house prices (Pearson correlation coefficient of 0.69) indicates that residential property prices tend to rise with the cost of lending. This may encourage homeowners to sell, but it may also reduce the affordability of housing for new buyers.
Market liquidity	The lock-in effect caused by rising mortgage rates leads to a reduction in the number of offers on the market and may limit market liquidity. Innovative solutions, such as refinancing programmes and incentives for new construction, are needed to keep the market active and to ensure flexible lending terms.
Strategic regulation of mortgage rates	Effective regulation of mortgage rates by the government and regulators can serve as a powerful tool to stimulate the development of the housing sector by adapting market conditions to economic cycles and the needs of the population

Source: systematised by the author

methods, such as public construction or policies aimed at increasing purchasing power, rather than relying solely on mortgage lending. However, in the current context of budgetary constraints and financial market preferences, the implementation of such policies may face significant challenges.

Effective management of mortgage rates and the development of policies to support stability and growth in the housing market are important tasks for regulators and governments.

4. Conclusions

Mortgage lending plays an important role in the development of the housing sector through its direct impact on the ability to finance property purchases and its indirect impact on the pricing and investment attractiveness of the sector. Changes in mortgage interest rates affect demand, supply and prices in the residential property market. Rising

rates can reduce demand and slow house price growth, while falling rates generally stimulate demand and can lead to price increases. Nevertheless, it is important to understand that such changes can have ambiguous consequences, including the risk of market overheating and the formation of "price bubbles" that threaten the long-term stability of the sector.

Mortgage lending undoubtedly stimulates construction activity by facilitating the realisation of new projects and the expansion of the housing stock. The impact of mortgage rates on the real estate market is not unambiguous, however, and depends on many factors, including economic conditions, central bank policy, consumer confidence and other macroeconomic conditions. Given the potential risks and challenges, mortgage lending policy requires a prudent approach to support the stable development of the housing sector and prevent potential destabilisation of the real estate market.

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