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Evolutions in real estate

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ABSTRACT

The residential real estate market plays a significant role in the Belgian economy and in the Belgian financial system as it closely interconnects financial institutions, households, and the real economy. Many past financial crises have shown that unsustainable developments in residential real estate markets can be the source of financial sector vulnerabilities and crises, requiring close monitoring and – if necessary – macroprudential measures to identify and address emerging imbalances. The article summarises the main elements of the presentation "*Residentieel vastgoed en financiële stabiliteit*" (Financieel Forum Oost-Vlaanderen, 30 mei 2022) which, in turn, was a preview of the National Bank of Belgium's Financial Stability Report published on 7 June 2022.
A thematic article in this publication provides a detailed and comprehensive analysis of recent developments in the Belgian residential real estate market. The Financial Stability Report also provides an update on the rationale and effectiveness of the macroprudential measures that the National Bank of Belgium has taken to mitigate risks to financial stability linked to the Belgian financial sector's significant exposure to the housing market. It shows amongst other things that the Bank's prudential expectations for mortgage lending standards, introduced in 2020, seem to have achieved their dual objective: reducing the share of riskier loans in new mortgage loan production while maintaining access to credit for solvent borrowers, including (young) first-time buyers.

The presentation "*Residentieel vastgoed en financiële stabiliteit*" (*Financieel Forum Oost-Vlaanderen, 30 mei 2022*) was a preview of the National Bank of Belgium's Financial Stability Report published on 7 June 2022.

A thematic article in this Financial Stability Report provides a detailed and comprehensive analysis of recent developments in the Belgian residential real estate market. It covers developments in house prices and housing transactions, new mortgage lending, credit standards, household debt, credit quality and vulnerabilities in the mortgage loan portfolios of financial institutions. It shows that, despite the impact of the coronavirus crisis on the Belgian economy, the Belgian residential real estate market remained resilient. Housing sales recovered rapidly, there was no correction in house prices (on the contrary), and the default rate for mortgage loans declined further. In addition, a significant improvement was observed in credit standards (loan-to-value ratios) for new mortgage loans, following the implementation by the National Bank of Belgium (NBB) of a new macroprudential measure (the so-called prudential expectations for institutions granting mortgage loans).

Yet, the very dynamic growth in new mortgage lending in recent years has also led to a further increase in the debt level of Belgian households. At the end of 2021, their total outstanding debt amounted to € 323 billion. Expressed as a share of GDP, the debt ratio of Belgian households has increased from around 40 % in 2005 to 62% at the end of 2021 and it is above the euro area average since 2016. Mortgage loans account for almost 90% of this debt and these loans are predominantly held by the domestic banking sector, which has a very significant and systemic exposure to the domestic residential real estate market. At the end of 2021, the amount of Belgian mortgage loans on the balance sheets of Belgian banks came to € 247 billion or 20% of their total assets, which is more than double the 2008 figure (€ 120 billion and 8% of total assets). The Belgian banks are therefore very vulnerable to shocks affecting this market.

To mitigate risks to financial stability linked to the Belgian financial sector's significant exposure to the housing market, the Bank has in the past taken a series of macroprudential measures (for more details, see also the NBB's Macroprudential Report published on 7 June 2022).

At the beginning of 2020, it issued prudential expectations for financial institutions that grant mortgage credit. These recommendations aim to improve the average credit quality of new loans, in particular by reducing the share of mortgages with a high loan-to-value (LTV) ratio. Individual financial institutions must declare annually to the Bank that they comply with these prudential expectations or, where applicable, justify the reasons why they have not complied with them. The compliance reports show that the financial institutions have broadly followed the NBB's recommendations, or, where relevant, provided explanations showing that their credit policy was healthy. The level of compliance is also illustrated by the decline of the share of high-LTV loans in the new production of mortgage loans since 2020.

For first-time buyers, for whom the NBB prudential expectations are the most flexible, the percentage of loans with an LTV higher than 90% — i.e., the reference threshold applied by the NBB

— declined from 45% in 2019 to 32% in 2020 and 25% in 2021. This percentage has therefore fallen considerably below the margin of tolerance defined by the Bank, according to which 35% of these new mortgage loans may exceed the threshold of 90% LTV. The persistent dynamics in mortgage loan production and the fact that the margins available for granting loans with a high LTV have not been completely used up, show that the Bank's recommendations leave sufficient room for manoeuvre for the mortgage market to remain accessible for solvent first-time buyers. Furthermore, data from the Central Individual Credit Register show that the share of loans granted to borrowers aged under 35 in the total of new loans has remained stable over the course of the past few years at around 35%. Combined with record total mortgage loan volumes granted in 2021, this means that there have never been more loans granted to young borrowers than in 2021.

As regards buy-to-let loans, which are considered riskier, the NBB has established a lower reference threshold and a smaller margin of tolerance. The share of these loans with an LTV over the threshold of 80% has considerably dipped, going from 33% in 2019, to 18% in 2020 and 11% in 2021, a level currently close to the 10% tolerance margin set by the NBB. In the evaluation of compliance by the financial sector to the expectations, the NBB has considered that the explanations provided justified exceeding the margin of tolerance in the sense that they confirmed that the financial institutions applied a sound credit policy for this segment, where necessary by, for example, requiring other types of (pledged) collateral than that taken into consideration in the loan-to-value calculation.

The Bank's prudential expectations seem thus to have achieved their dual objective: reducing the share of riskier loans in new mortgage loan production and maintaining access to credit for solvent borrowers, including first-time buyers.

The lending standards in recent production have however not yet improved to the point of justifying any change to the second macroprudential measure. This measure consists of a supplementary capital buffer destined to cover systemic risks in mortgage loan portfolios held by banks that use an internal risk model for calculating the minimum capital requirements. This calculation generally provides low risk weights because Belgium has never experienced a housing crisis. It therefore underestimates the potential losses in the event of a major market shock. The buffer was introduced in 2013 and subsequently extended and amended on various occasions until the end of April 2023. This capital buffer amounts to approximately € 2 billion for the entire banking sector.

In a context in which the probability of risks materialising on the property market has increased, the National Bank of Belgium is ready to release this macroprudential capital buffer if, for example, there is a substantial rise in payment difficulties for mortgage borrowers. In case of a release, banks can then use this buffer to absorb losses related to payment defaults but also to finance debt restructuring solutions for clients with repayment problems. While taking into account the risks, such pro-active debt restructuring solutions would help to avoid a wave of payment defaults, house evictions and forced property sales that would constitute a procyclical amplification of financial stress in the residential real estate market in case of a large negative shock.

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