



FINANSTILSYNET

THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY

ESRB-ECB-IMF
Macroprudential Policymaking for the Real Estate sector

Session 4: Commercial Real estate
The case of Norway

Frankfurt

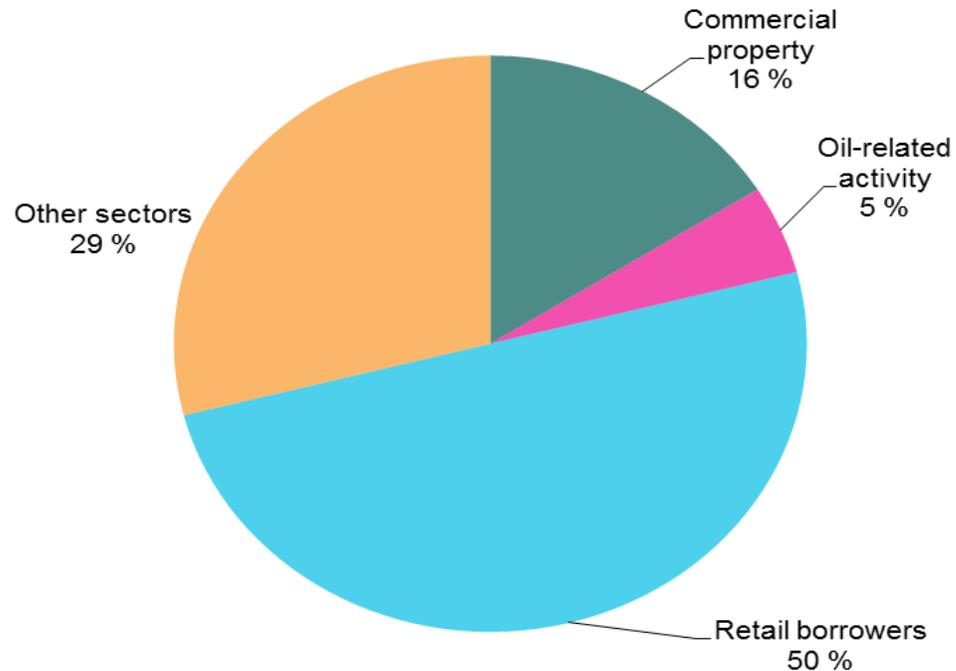
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FSA

- Current situation in the property markets
- Historic experiences on commercial real estate exposures
- Measures implemented in Norway

Banking exposures - Norway

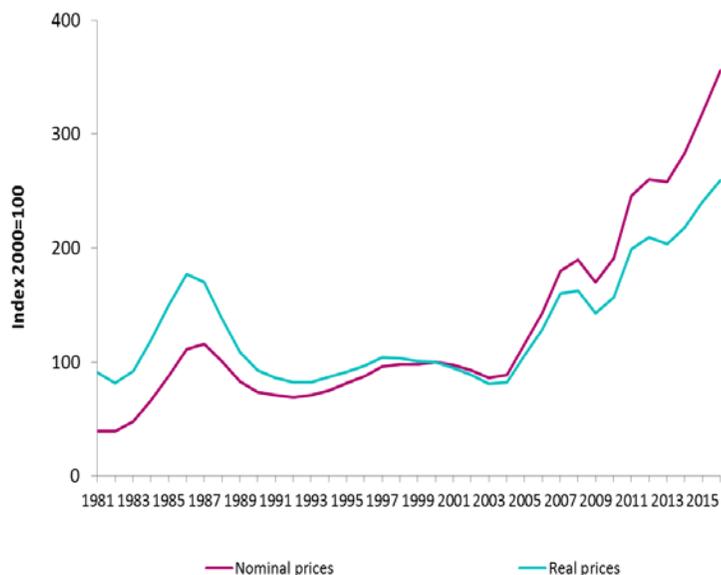


- Banks heavily exposed to property markets - 2/3 of lending, but also through funding and liquidity

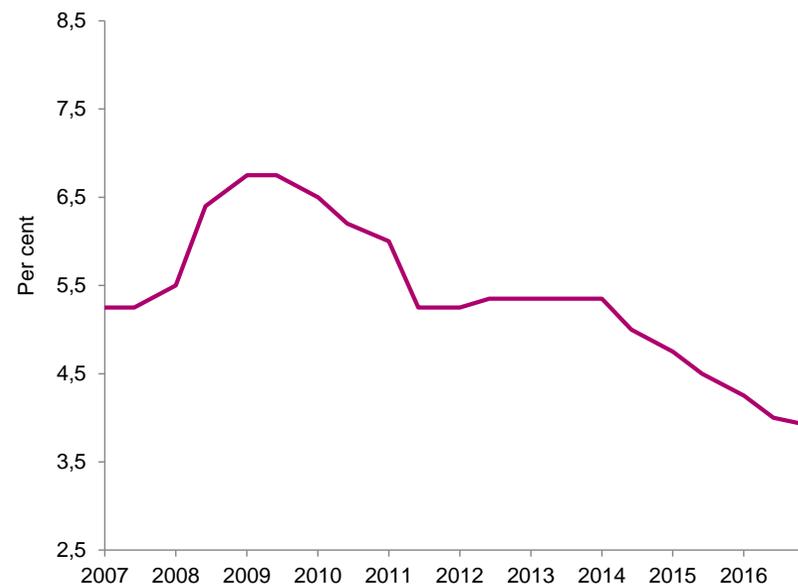
Commercial real estate (CRE)

(Oslo, central location, high standard)

Prices



Yield

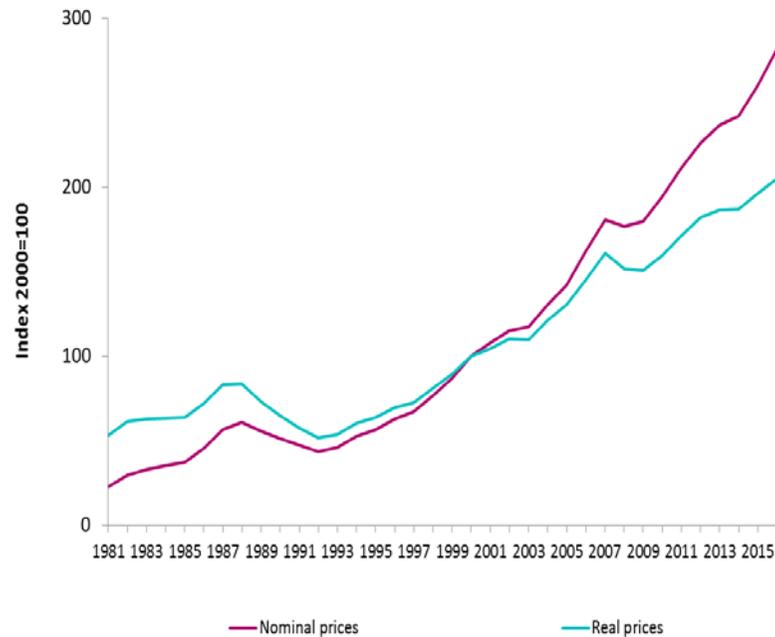


Sources: OPAK, DN, SSB and FT

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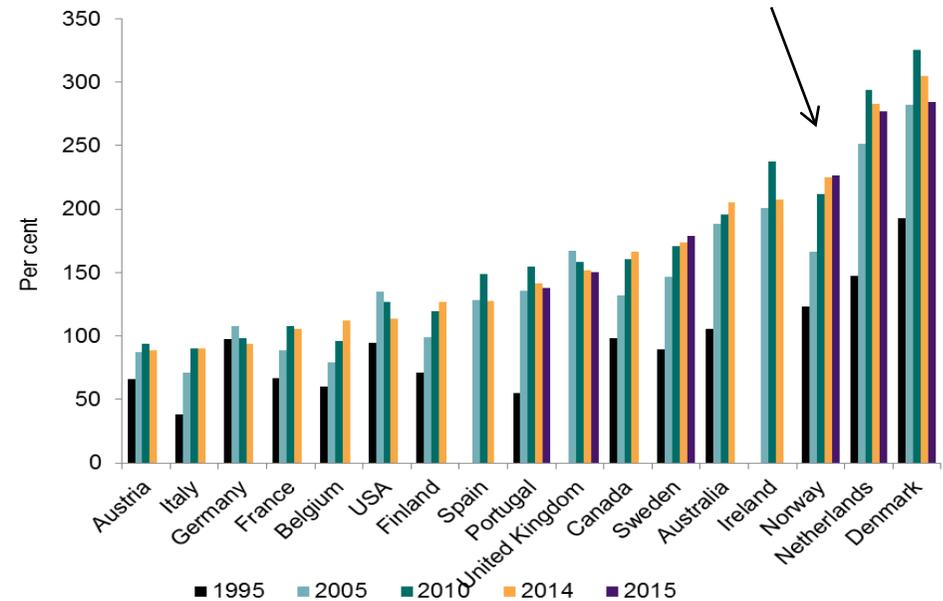
Residential real estate (RRE) and household debt

Residential real estate



Sources: Eiendom Norge, Norges Bank, Statistics Norway

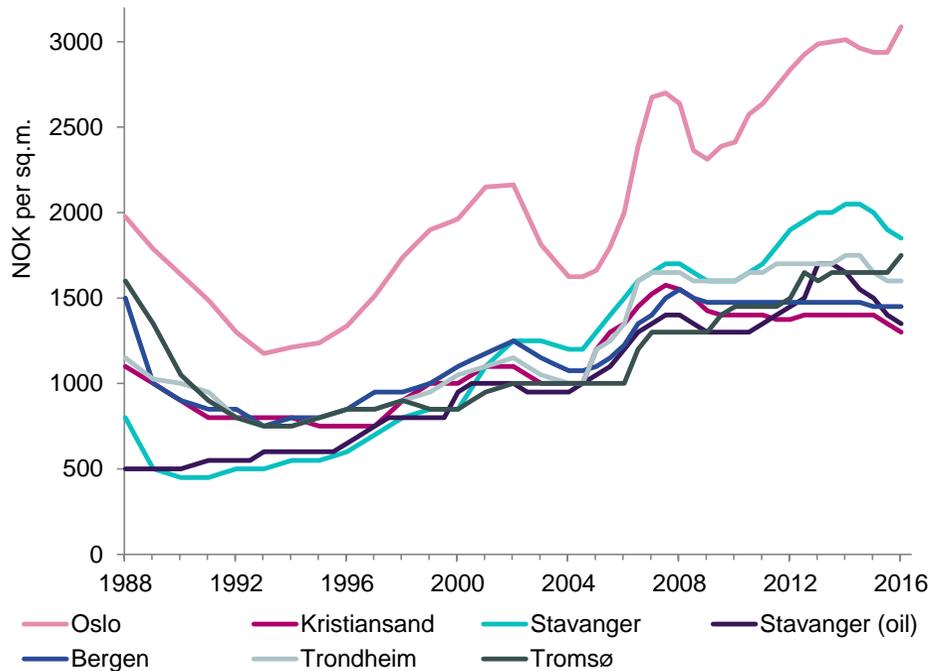
Household debt (Debt to disposable income)



Source: OECD

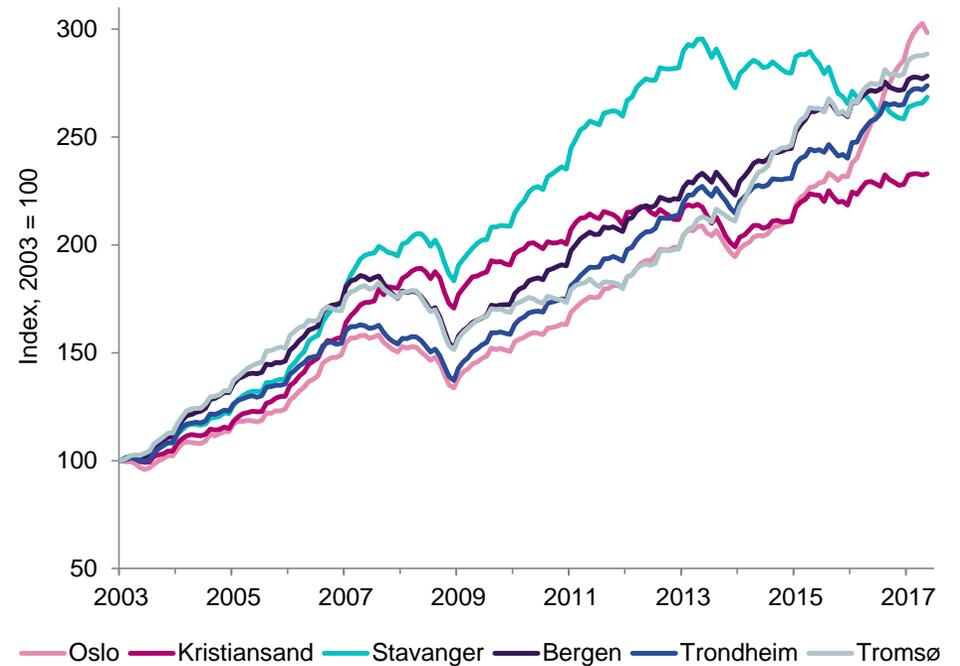
Significant regional differences

CRE - Rental prices, largest cities



Sources: OPAK and DN

RRE – largest cities



Sources: Eiendomsverdi, Eiendom Norge and Finn.no

Business cycle and bank losses

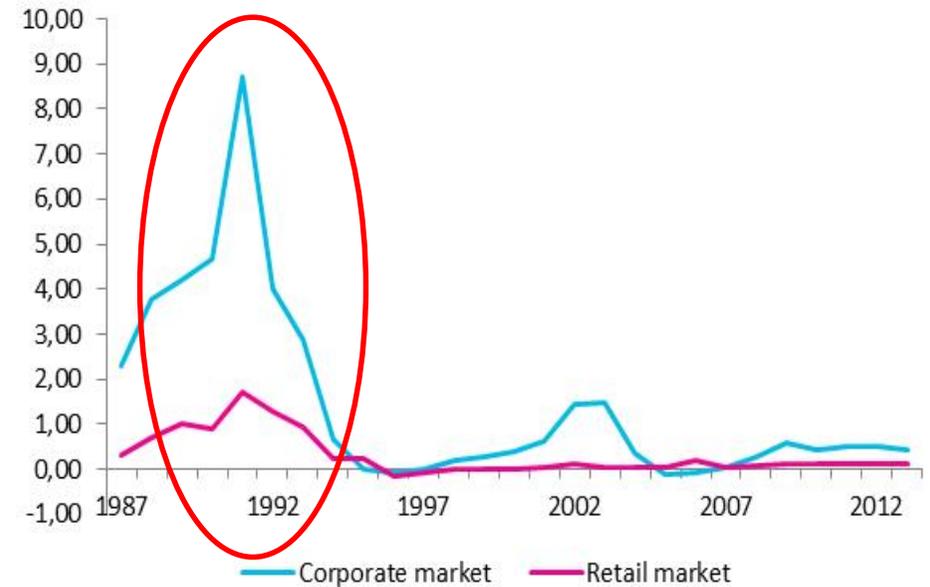
During the Norwegian banking crisis (1988-92)

Bank losses, growth in GDP and private consumption



Sources: Statistics Norway and Finanstilsynet

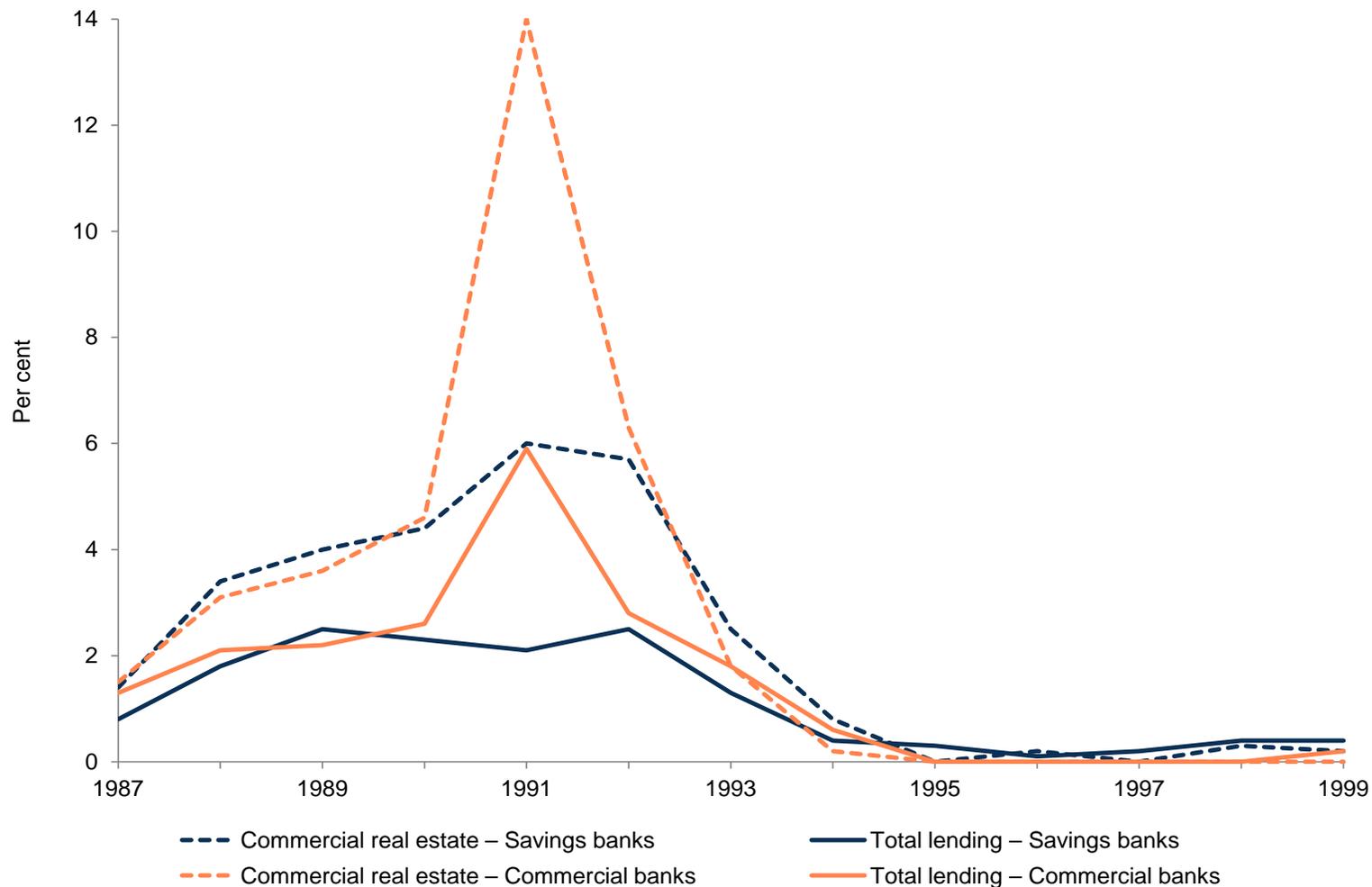
Bank losses – retail and corporate (per cent of total loans)



Source: Finanstilsynet

Loan losses – CRE

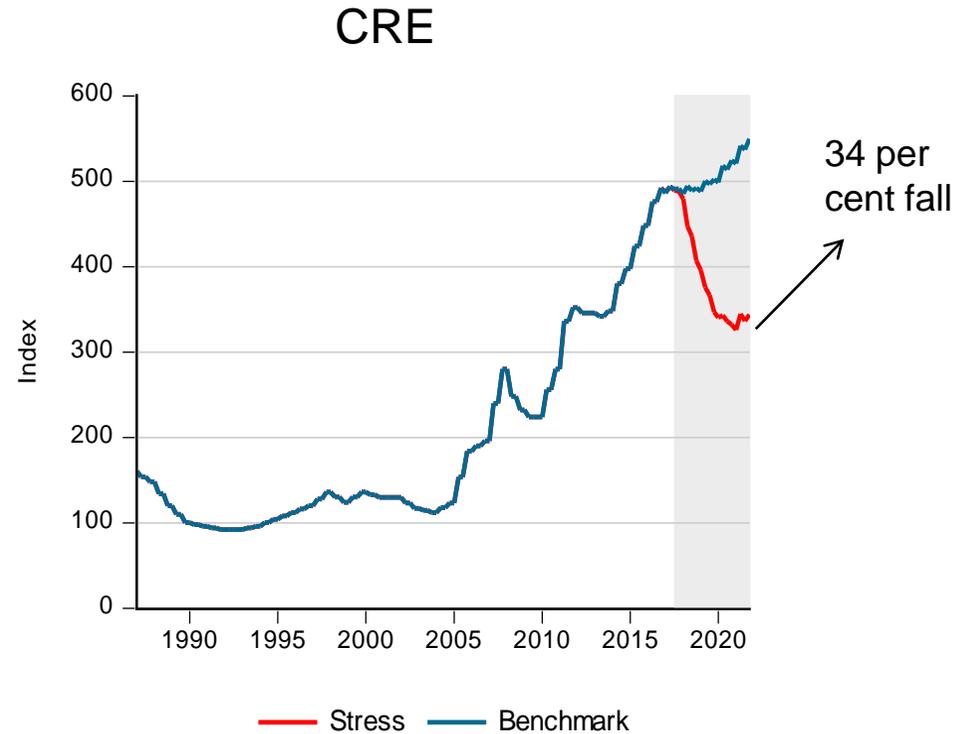
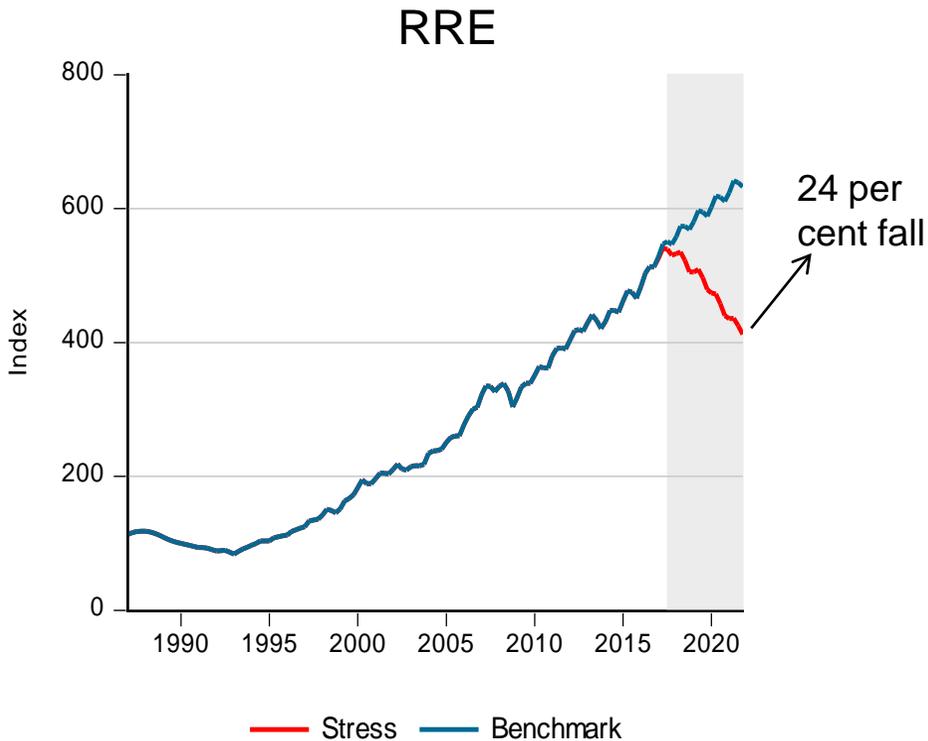
During the Norwegian banking crisis



Drivers for CRE and RRE

- High and rising household debt and RRE prices represent a risk to financial stability in Norway. A sudden, sharp decline in RRE prices and a household consolidation will spill over to CRE and significantly increase banks' losses
- Main drivers for CRE and RRE in Norway are cyclical, and fundamentally the same: Low interest rates/low yield, expected income/rental growth, high and increasing household leverage
- Investment/speculative drivers in both markets, and a financial accelerator in both markets. Significant foreign investment in CRE in Norway and investments from life insurers, as well as increased bond financing of CRE transactions
- A setback may be triggered by an unexpected, significant increase in interest rates and/or an international setback, or a shift in sentiments

Stress testing of the banking sector (Finanstilsynet's Macro model, NAM-FT, for the Norwegian economy)



- Stress period 5 years.
- Lending rates increasing by 3,5 pp, negative growth in GDP, consumption and investments, reduced oil-prices

Norway: Measures taken

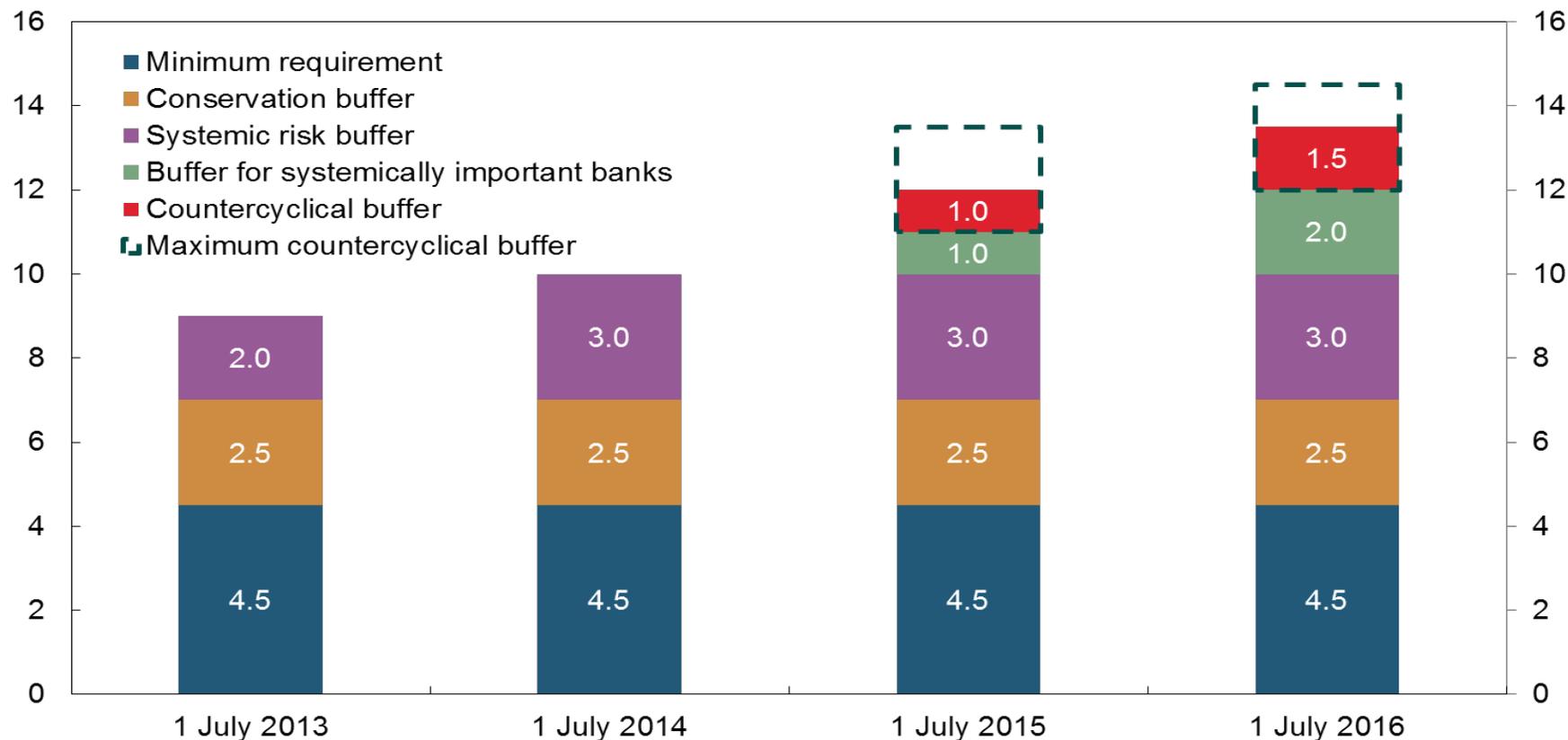
	RRE	CRE
• Counter cyclical buffer	Yes	Yes
• Systemic risk buffer	Yes	Yes
• Sectoral capital requirements	No	No
• Risk Weights (IRB)	Yes (mortgages)	Yes (corporate RW)
• Risk Weights (SA)	No	Yes (100 per cent all CRE loans)
• Lending regulation	Yes (LTV, DTI, DSTI, amortisation)	No
• Pillar 2	Yes	Yes (<i>CRE-concentr., Single Exposures</i>)
• Stress testing	Yes	Yes

Measures

- Measures along two broad categories; resilience through increases in, and robust measures of, CET-1, as well as through ensuring sound lending practices
- Sectoral capital requirements are not applied;
 - ✓ Capital will to a minor degree address lending growth either to RRE or CRE
 - ✓ A materialisation of the main risk will hit broadly
 - ✓ Fine tuning should be avoided (as long as the main drivers cannot be addressed by credit supply measures)
- While a lending regulation on mortgages is implemented, credit practices for CRE lending is only handled through (micro) prudential supervision and stress tests based on exposure level data

Common Equity Tier-1 capital requirements

2013-2016 per cent of risk-weighted assets



Source: Ministry of Finance

- CCyB 2,0 per cent from end 2017
- Pillar 2-requirement (legal) in the interval 1,5-3,0 per cent for the larger banks. Capital Guidance
- Back-stops: Leverage requirement of 5 per cent (6 for SIFIs). Floor on RWA

Supervision of lending to CRE

- ✓ Ensuring sound lending practices on CRE is addressed through micro prudential supervision and granular stress testing.

- ✓ On-site inspections of CRE addresses the following;
 - Credit strategies, credit limits, internal guidelines
 - Methods in valuation – yield (typically underestimated), rentals (overestimated)
 - Quality of exposures (i.a. risk classifications, migration, NPL, forbearance, provisioning)
 - Transaction testing of a risk-based selection of exposures
 - Audit reports, risk management reports, stress tests/sensitivity analyses, industry reports

- ✓ Finanstilsynet uses its risk classification system of non-financial companies, linking this to each bank's actual exposures, to benchmark the bank's own risk classification

LTV on CRE?

- A financial accelerator is at work both on RRE and CRE; better collateral leads to higher lending and higher values increases investors' demand

- Calibration of a “standard” maximum LTV is challenging due to the heterogeneous nature of properties and relatively few transactions on which to base valuation methods. In addition to properties' quality/location and tenants' financial status, valuation depends on;
 - ✓ Contracts in relation to minimum required occupancy rate
 - ✓ Term/residual term of rental contracts compared to presumed market rent
 - ✓ The property's flexibility and alternative use
 - ✓ In case of apartment/housing projects – the proportion of pre-sales

- Setting a LTV on CRE entails challenges linked to scarcity/low quality of data and methods of valuation. Further work has to be done

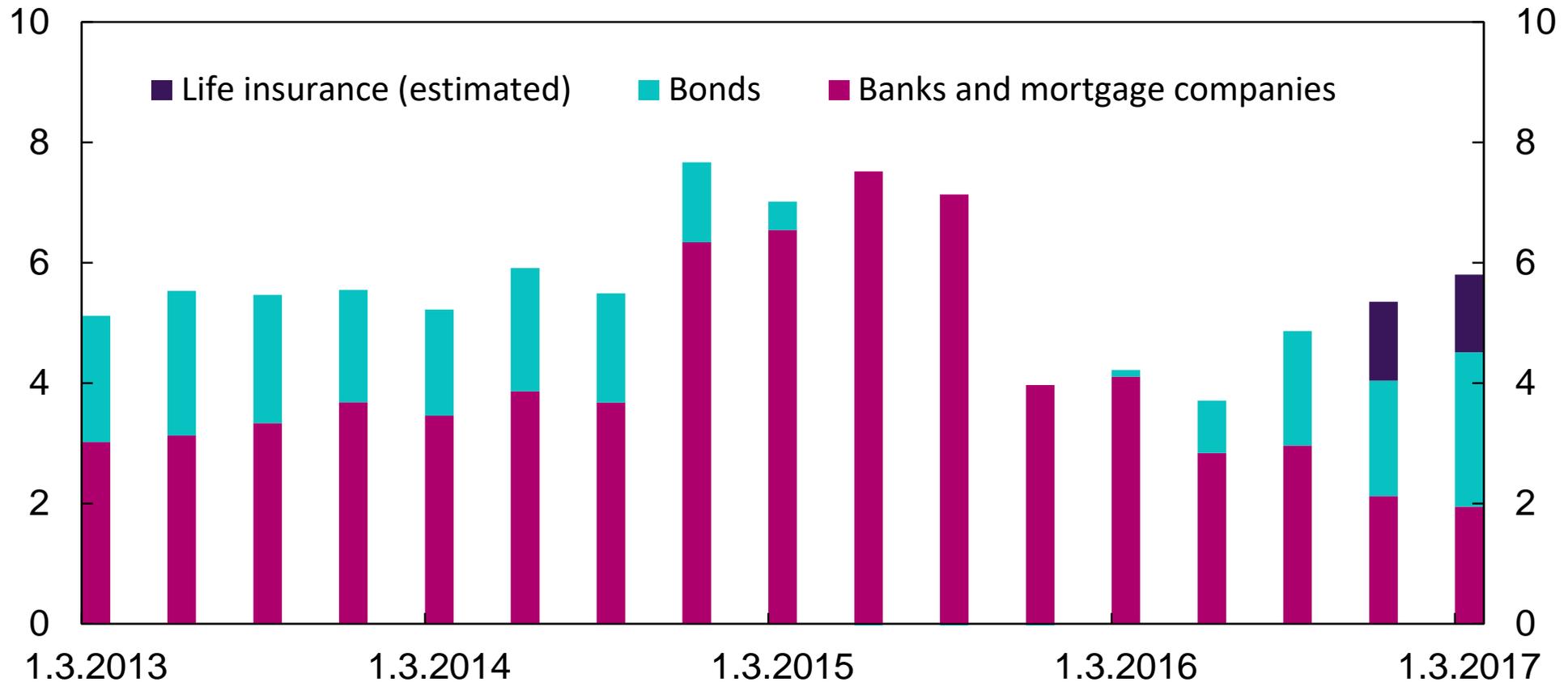
Stress testing of the CRE portfolio

- ✓ Granular stress testing of CRE in 2013/2014 based on:
 - Banks' exposures (consolidated) reported to Finanstilsynet
 - A macro stress scenario for 3 years, based on the actual, adverse developments experienced in the period 1989-1991
 - Rental income reduced by 33 per cent, interest rates increased by 5 percentage points, valuation of property reduced by 33 per cent
 - Results were measured on customers' cash flow and collateral
 - Only 1/3 of customers managed to service their debt through the stress period
 - Similar results when the scenario was run by the banks themselves

- Banks' results followed up with each bank. The extent of banks' own stress testing of their CRE portfolio were low and has been somewhat improved after the stress test in 2013/2014.

CRE - Credit growth

(12-month growth, per cent, Q1 2013 - Q1 2017)



Source: Norges Bank

Reciprocity

- Norway has a significant presence of foreign branches (1/3 on corporate lending, less on mortgages)
- Three branches would have been SIFIs under SIFI-regulation in Norway, had they been subsidiaries. The second largest bank became a branch under EU-regulation as of 2017
- Home authorities are responsible for supervision, and capital measures have largely to be based on voluntary reciprocity. Lending regulations on mortgages applies to branches
- A MoU between the Nordic countries and the ECB/SSM. Signatories have agreed to strive for reciprocity on macro- and micro prudential measures

Summing up

- ✓ CRE and RRE prices have increased significantly. Both markets are driven by cyclical factors and financial accelerator effects. Some signs of lower growth rates in RRE markets.
- ✓ Macro prudential measures applied, but relatively more weight on micro prudential measures on CRE than on RRE
- ✓ Banks' resilience has been significantly improved through general capital requirements
- ✓ Sound lending is addressed through lending regulation on RRE. Lending to CRE is, in the case of Norway, addressed through more granular, micro prudential approaches. LTV on CRE and sectoral capital requirements are assessed, at this stage, less effectively
- ✓ Reciprocity is of essential importance in a banking system with significant presence of foreign branches

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