

# Research Nordic

## Housing boom coming to an end

### An overview of the housing market situation and discussion in the Nordic countries as the COVID-19 crisis is coming to an end.

All Nordic countries have experienced sharp increases in residential property prices with Sweden and Denmark in the lead while Finland is the laggard. Due to record low mortgage rates, however, affordability is fair on average in all countries. However, it is low or very low in parts of the major cities. A Covid19-induced search for more workspace at home and a coincident lack of supply also appears to be in play. Looking forward, we expect price gains to moderate in all countries.

A consequence of the previous rise in prices is accelerating credit growth and higher debt ratios, with the exception of Denmark. Household indebtedness varies quite substantially between countries, Denmark having the highest.

All countries currently faces pressures to tighten regulations in some form, either from the FSA, central banks or the Governments. Prime reasons appears to be an attempt to limit household debt and moderate financial system risks. Whether this is consistent with other priorities such as lowering barriers for first-time buyers to enter the housing market appears unclear.

In terms of the regulatory environment Sweden and Norway have the toughest LTV restrictions, 85%. Finland has no mandatory amortization requirement, probably because a strong endemic amortization culture. Sweden probably has the toughest amortization requirements. Norway appears alone in having a 500 % loan-to-income ceiling. A KALP rate (hypothetical interest rate that borrowers' economy is tested against) of 6 % in Sweden and Finland is at the high end.

In terms of taxation, Sweden is the odd one out. Sweden has no property tax (but a basically constant fee), while this is the case in other Nordic countries. Instead, there is no tax on capital gains if lived in it for a maximum of 2 years, except in Sweden where it is 22 %. All countries have interest rate deductions varying from about 30 % in Denmark and Sweden down to 10 % in Finland.

Swedish FSA decided to reinstate mandatory amortization from Aug 31 and the Government is contemplating a reduction/abolition of the interest rate deduction. The Danish SRC is expected to propose new measures, perhaps a higher down payment (lower LTV) and limits to interest-only loans. A tax value reassessment overhaul is also in the cards, supposedly with an overall neutral effect. In Norway, the focus is on limiting secondary home purchases as a "financial investment" by requiring a 40 % down payment. In Finland, Bank of Finland has proposed a debt (or loan) to income cap.

### Today's key points

- **Denmark:** houses remain reasonably priced on average but concerns are rising in high-price areas.
- **Sweden:** already high prices have been driven higher, supported by a decline in lending rates that is coming to an end now.
- **Norway:** prices are driven up both by increasing spending power in households and a lack of new housing supply.
- **Finland:** prices have risen less than in the other Nordic countries, but with large regional differences.

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## Simplified overview of restrictions and taxes

Lending restrictions	Sweden	Denmark	Norway	Finland
LTV ceiling (%)	85	95	85	90 (95 for first time buyers)
Amortization requirement (%)				
< 50 % LTV	0			
50-70 % of LTV	1	None unless interest is variable and LTV > 60%	>60% LTV: 2.5%	None
71-85 % of LTV	2			
loan > 4.5 * gross income	1			
Left to live on (KALP) rate	6	4 in high price areas		6
<b>Taxation</b>				
Property tax	No	1.6% - 3.4%	Local	0.41 % - 1.0 %
Property fee	0.75% of tax value or max 8349 kr	0.92% - 3% of 2002 value		
Interest rate tax deduction	30% up to 100,000 kr, then 21%	22.8% - 34.3%	22%	10%
Capital gains tax	22% on capital gain incl. Deduction for improvements	None if lived in	22% unless lived in 12 of last 24 months	30% - 34% unless lived in over 2 years
Transfer tax	Deed: 1.5% Mortgage: 2%	Deed: 0.6% + 1,750 Mortgage: 1.45% + 1,750 kr.	2.6% in most cases	2% - 4%

Source: Danske Bank. This table is only indicative and not a guide to how any individual loan is treated.

# Denmark

## Expensive houses, cheap to finance

As of May, the price of single-family houses in Denmark is up by 15.7% on a year earlier, while the much smaller markets for owner-occupied apartments and summer houses have seen price increases of 17.9% and 26.4%, respectively. In our view, the acceleration in prices has been driven by the change in spending patterns during the COVID-19 crisis, but also supported by the delayed effect of declining borrowing costs over the preceding years. The Danish housing market entered the crisis with a historically high level of affordability for first time buyers, excluding amortisations. Even when including amortisation in the calculation, it is still easier to afford an average house than it has been on average historically, but that is not true for the market in Copenhagen and to some extent other major cities. It is possible to have mortgage loans without amortisation, but the credit assessment is done on the assumption that the loan will be amortised, so the borrower must be able to afford that.

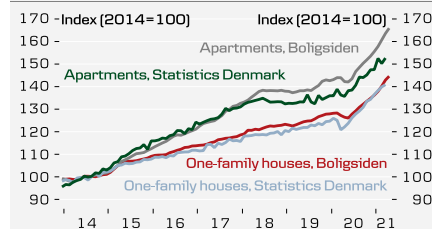
We expect house prices to decelerate as reopening allows people to spend more time and money on other things than housing, but we do not expect a correction in prices back to pre-crisis levels. A significant decline in house process would, in our view, require a substantial increase in interest rates or a new and deep economic setback. We also do not expect prices in Copenhagen to decline but see a bigger risk there, partly related to regulation and taxation.

## New regulation being discussed

The Systemic Risk Council expects to propose new regulation to dampen house price growth in high price areas on its meeting on June 21. Possible suggestions include increasing the down payment requirement from the current 5%, lowering loan-to-income ceilings or limiting access to interest-only mortgage loans. However, it is by no means certain that the government will follow the proposals. Higher down payment requirements will make it more difficult for first time buyers to enter the market, while limiting access to interest-only mortgage loans (the cheaper loans up to 80% of the value) will make it more difficult for borrowers to rapidly pay off bank loans (more expensive loans for the remaining up to 15%). Also, any proposal along these lines will increase the already high level of aggregate saving in the Danish economy – the current account surplus over the last 10 years has been 7.7% of GDP on average. In contrast to the period leading up to the financial crisis from 2007, there are few signs that rising house prices have led to an increase in household debt at this point.

New regulation is one possible factor that might reduce house prices in some areas. Another is the planned change in the taxation system. Current housing and land taxation is based on obsolete value assessments, and a new system is expected to lead to higher taxes in some of the more expensive areas, especially owner-occupied apartments in Copenhagen, from 2024. The change could affect prices before that, as new value assessments are sent out, which is planned to begin happening this year. We estimate that a 5-10% reduction in prices, all else equal, for owner-occupied apartments is a realistic isolated effect of the tax change. However, the new system will not increase the total taxation, so taxes in other areas will be lowered (in addition, taxes will not increase for any current owners, only future ones). The new value assessment system is already delayed and could very easily be delayed further. Once the new system is in place, that will serve to dampen volatility in house prices going forward, as taxation will change in line with values.

### Accelerating prices



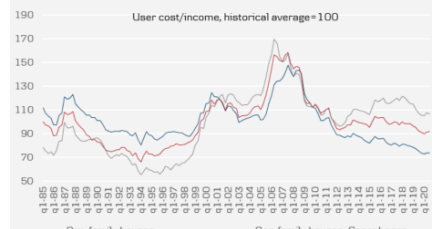
Sources: Boligsiden, Statistics Denmark, Macrobond Financial

### Borrowing costs have been declining



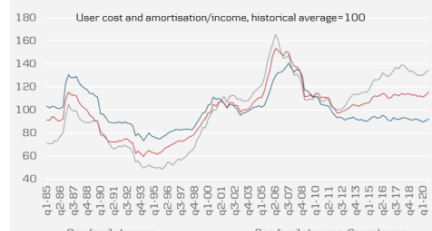
Source: Danmarks Nationalbank, Macrobond Financial

### It is cheap to own a house



Source: Realkredit Danmark

### But can be difficult to afford



Source: Realkredit Danmark

# Sweden

## Expensive gets even more expensive

By April 2021, the average property price had risen by 18 % vs December 2019, driven mainly by a 23 % increase in single-family house price and leaving the increase in owner-occupied apartments well behind with a 9 % gain. This divergence illustrates well the hunt for bigger living space caused by Covid19. Our own Boprisindikator measuring owner-occupied apartment prices in Stockholm, shows a similar picture within apartment: it is the bigger ones that have gained the most. Despite the staggering price developments last year, affordability (Boindex) was well above the norm in Q1 in Sweden on average (at 111). However, the indices for single-family houses in the three major cities were all below the 100 index level, implying more than 30 % of DI was used to buy a house. This is actually close to the average since the survey started in 2005. The difference now is that mortgage rates are lower and prices have outpaced incomes.

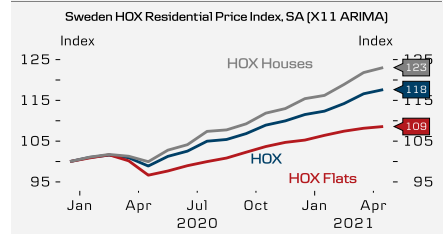
Prices have so far been bolstered by declining mortgage rates. Most likely, however, these have reached a bottom in the past few months. Hence, it seems quite likely that the price gains will moderate going forward. We do not expect prices drop unless there is an unexpected event such as a stock market crash or a change in housing taxes. The reinstated amortization requirement on August 31 is likely to have a dampening although not detrimental effect on prices.

Households' aggregated debt ratio is approaching 200%. However, according to FSA's most recent survey the corresponding ratios for new home buyers in 2020 was 425%. In Stockholm, that ratio was 530%. The corresponding LTV ratios were 74 % and 71 %. There is a 15 % down payment requirement. Loans in the range of 50-70 % and 70-85 % of LTV need to be amortized by 1 % and 2 % per year respectively. In case loans exceed 4.5 times gross income there's an extra 1 % amortization requirement. Hence, a rough estimate of the implied loan size when this becomes binding is about SEK 2.7 mln compared to the average loan size of SEK 2.5 mln. A similar calculation for Stockholm suggests the binding loan size is SEK 3.0 mln vs average loan size of SEK 3.5 mln. Hence, on average home buyers in Stockholm appears to pay the 1 % extra amortization and in total 3 % per year (or almost 9 000 kr per month) which is > 15 % of DI. Stockholm accounts for almost 40 % of all new loans. All home buyers must also pass banks' KALP test (LTLO or left to live on) in which a 6 % interest rate should be afforded. That is a level 4 times higher than the current 3m-5y mortgage rates (range 1-1.5 %), a level that seems completely unreasonable. Recent price gains have of course tightened all these restrictions further.

## Possible new regulations

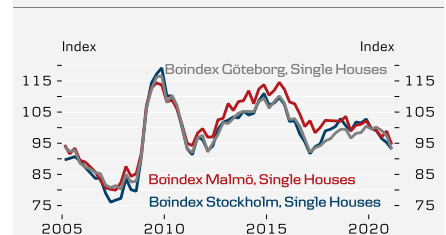
From time to time a few suggestions arise in the Swedish debate about how to slow price increases, to increase mobility and to make it more affordable for younger people to acquire a property. First, a re-introduction of a proportional property tax is the prime idea among academic economists. If introduced it might have a severe impact on housing costs and hence prices. 2) Another idea is to abolish the 30 % interest rate tax reduction gradually over a number of years. This would raise interest costs by approximately 40% with unchanged rates and would have a similar impact as a property tax. 3) A third idea is to reduce the current 22% capital gains tax on properties. This would increase mobility as many older property owners are "locked in" by tentative big tax payments. They simply cannot afford to scale down new costs for a smaller property might be even higher.

### Soaring prices as buyers pay up for bigger space



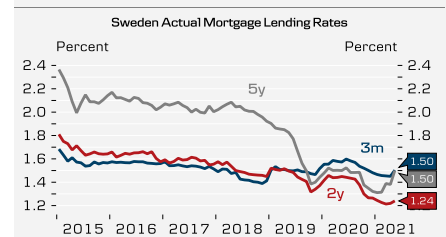
Sources: Valueguard, Danske Bank calculations

### Single-house s affordability is very stretched in the three major cities



Source: Swedbank

### Mortgage rates has probably bottomed



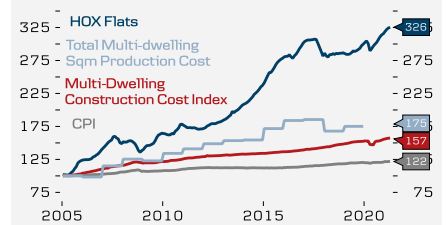
Source: Average of major housing credit institutions in Macroband

## Other factors

Most of the discussions focus on measures to moderate prices via tighter financing conditions. However, one reason for higher property prices may also be a lack of affordable rentals. Old ones are hard to come by and new have a very high rent where owner-occupied apartments often turn out better. The rent market is strictly regulated and queues are sometimes very long.

Residential property production costs are rising at almost the same pace as property prices. And at almost twice the pace of CPI inflation. Whether the prime reason for this is authorities regulations and land costs or soaring producer profit margins and limited competitiveness is debated. Regardless of which, it seems necessary to bring down costs to produce cheaper properties in the future.

Is there a production cost problem?



Source: Valuaguard, SCB

# Norway

## Lack of supply and higher purchasing power pushing prices

In May, housing prices in Norway was up 11.4% y/y. There are large regional differences, where the tendency of course is stronger housing prices in larger cities. In Oslo, prices were up 12.4% y/y in May, above the national average.

Lower interest rates have naturally boosted purchasing power and contributed to higher prices, but there is also no escaping the fact that low construction activity ahead of the pandemic resulted in a supply deficit that is pushing up prices through competitive bidding. This has been reinforced by the change in spending patterns during the COVID-19 crisis seen in other countries.

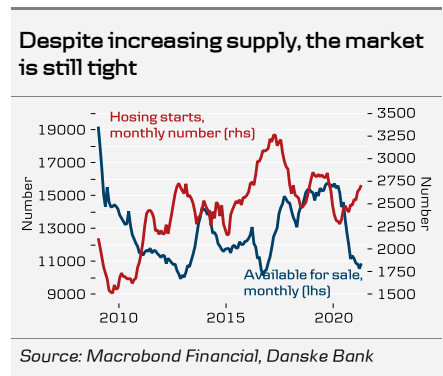
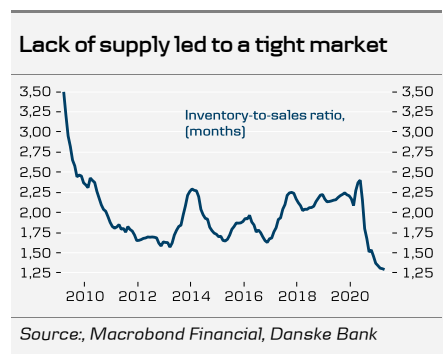
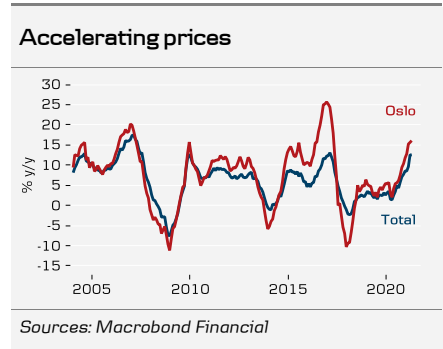
However, we think much of the increase in prices has already taken place, and we expect price growth to slow considerably in H2. Sales of new homes have picked up, and housing starts have begun to climb, which will gradually bring a better balance to the market during the autumn. At the same time, we expect interest rates to begin to rise gradually from September, and together with the prospect of further rate increases in the coming years, this is likely to put a damper on prices through the expectations channel. In addition, the recent rise in nominal prices has taken real prices roughly 10 % above fair value, according to HouseLab. As a result, price expectations has already peaked, and monthly price growth has slowed.

Due to base effects, we expect housing prices to rise around 9 % this year, but to slow to 2.5% next year.

## Regulations have dampened house price growth

From 2015 there have been a continued tightening of regulations of housing borrowing. Most important has been a limitation of Loan-to-income (currently 500 %), amortisation requirements and a required level of equity (15 %). Even if banks are allowed a flexibility quota of up to 10 % of new loans, these regulations seem to have contributed to dampen price growth. Especially the max LTI of 500 % has clearly had an effect in areas with a relatively high price level, as f.ex. Oslo. Also, the required level of equity for purchasing a second home is set to 40 %. The latter is clearly intended at limiting the scope of 'financial investments' in the housing market.

The FSA suggested to tighten restrictions in September last year, but the government refused, backed by, among others, Norges Bank. Interestingly, the main objection from NB was that 'requirements for sound lending practices should be regarded as a lasting, structural measure, and not changed frequently'. However, Norges Bank believes that the stricter requirement for equity when buying a secondary home should apply to the whole country and not just in Oslo.



# Finland

## Urbanisation drives housing market

Prices of old apartments per square meter in Finnish housing companies rose 4.9% year-on-year in April 2021. Prices in Greater Helsinki were up by 6.1%. For several years, the average house prices have seen only modest rise in Finland with very much geographical variation. Prices generally rise in small number of growth centres and fall in locations with shrinking population. Finland is behind many other EU countries in terms of urbanisation, which makes it likely that a similar main trend will continue. Remote working arrangements and travel bans related to Covid-19 have caused a temporary boom in second homes in the countryside, which we expect to calm down.

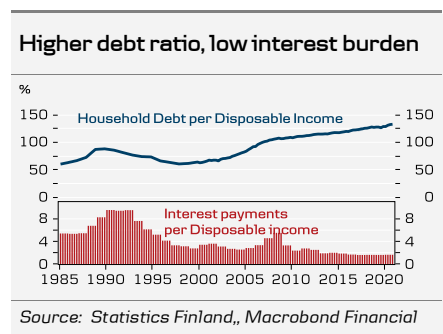
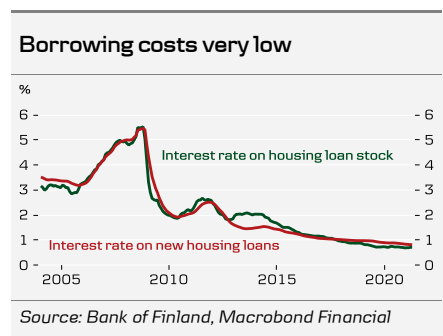
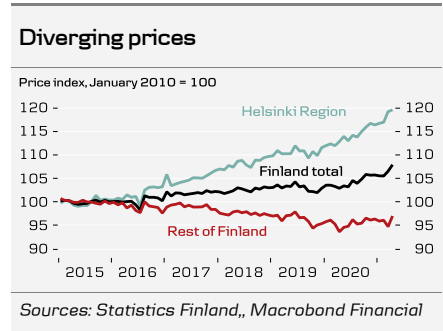
In recent surveys, household's intentions to buy housing and withdraw loans has risen to very high levels. The result is probably partly related to a new life situation where much time has been spent at home because of Covid-19. Institutional and private investor interest into real estate investment has also increased demand of housing property. The stock of housing loans stood at EUR 104.0 bn in April, and the annual growth increase was 4.0%. Buy-to-let mortgages accounted for 7.9% of the total housing loan stock, while the share of new drawdowns was 9.1% in April. Construction permits indicate increasing housing supply. At the same time, many of the buy-to-let apartments are empty without tenants. We expect price development to moderate, once people start to spend more time outside homes.

Finnish housing loans are most often linked to Euribor-rates. The average interest rate on housing loans stood at 0.81% in April. Many customers have hedged their interest rate risk, and we do not expect interest rates to rise much in the medium term.

## New regulation being discussed

The Financial Supervisory Authority (FIN-FSA) kept the maximum loan-to-collateral (LTC) ratio, and banks' capital requirements unchanged in March. Maximum LTC ratio stands currently at 90%, except that for first time buyer it is 95%. FIN-FSA is closely monitoring the housing market and household indebtedness, and urges banks to take particular care when assessing borrowers' ability to pay, especially in the case of large and long-term loans. According to Bank of Finland, vulnerabilities related to housing finance have increased in Finland during the COVID-19 pandemic. Long housing loans are being taken out more than before and a larger proportion of new mortgages are being granted to borrowers with high loan-to-income (LTI) ratio. Bank of Finland proposes a debt-to-income cap and a limit on the maturity of housing loans to stop the loosening of credit standards. A Ministry of Finance working group has proposed similar ideas.

Housing loans have performed well through the Covid-19 recession. Many customers took interest only periods in 2020, but most of these have expired without any problems. Bank of Finland states that the Finnish financial system has remained stable despite the pandemic. In our view, the good economic outlook makes things stable in the medium term, but longer term macroprudential stability could benefit from regulatory development. Tight loan-to-income ratios would make home acquisition more difficult for first time buyers without strong parental support. Limiting the maturity of housing loans or other methods, like limiting housing company debt growth, could lead to a more balanced outcome.



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