HCSF

Haut Conseil de Stabilité Financière

Press release - Annex

Paris, 14 September 2021

Assessment of Recommendation No. R-HCSF-2021-1 of 27 January 2021 on lending standards in the French residential real estate market

The HCSF's recommendation of December 2019 was designed to put a stop to the worrying deterioration in lending standards for residential housing loans

In October 2019, the HCSF published an assessment of risks in the residential real estate sector[1], which underlined that lending standards for housing loans had gradually deteriorated since 2015. It notably highlighted an increase in debt service-to-income (DSTI) ratios and in loan maturities, especially for the highest DSTI ratios and longest maturities. This easing of lending standards came at a time when the supply of housing credit was rising rapidly, interest rates were historically low, and debt-to-income ratios were already high among households, making them increasingly vulnerable to future crises. The sharp rise in the supply of housing credit also coincided with a rapid acceleration in real estate prices. While prices did not on the whole appear to be stretched, the trends in lending raised fears of speculative behaviour, at least at a local level.

A similar assessment was published by the European Systemic Risk Board (ESRB) [2], which issued an official warning to France on 23 September 2019 on the risks linked to its residential real estate market, as well as by the International Monetary Fund (IMF)[3].

To limit the associated risks to financial stability, the HCSF adopted a recommendation in December 2019 calling on credit institutions to impose tighter controls on their lending practices in the French residential real estate market. **This recommendation was adjusted in**

[1] The HCSF's assessment of risks in the residential real estate sector is available at: https://www.economie.gouv.fr/files/files/directions_services/hcsf/2019-Diagnostic-immobilier-en.pdf

[2] ESRB Warning No. 2019/12 of 27 June 2019 on the medium-term vulnerabilities in the residential real estate sector in France (ESRB/2019/12), available at: https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning190923_fr_warning~48c2ad6df4.en.pdf

[3] IMF, 2019, France: Financial Sector Assessment Program-Technical Note-Nonfinancial Corporations and Households Vulnerabilities: https://www.imf.org/-/media/Files/Publications/CR/2019/1FRAEA2019004.ashx

January 2021[4] based on a first assessment of its impact and in light of the practices observed among institutions. The final recommendation limits DSTI ratios on residential housing loans to 35%. It also restricts loan maturities to 25 years, to which can be added a maximum two-year grace period on repayments when there is a lag between the disbursement of the loan and the date when the borrower can move into the property.

The data show that lending standards have normalised since the recommendation was implemented

The share of loans with a high DSTI ratio and a maturity of over 25 years has fallen. New loans[5] with a borrower DSTI ratio of over 35% accounted for 18% of all new lending in July 2021, down 14 percentage points compared with January 2020 (Chart 2 in the appendix). Between January 2020 and June 2021, the average DSTI ratio fell by 0.9 percentage point to 30%. Similarly, the share of new loans with a maturity of over 25 years[6] fell from 12.8% in January 2020 to 6% in July 2021 (Chart 3). The average loan maturity nonetheless increased slightly, from 21 years and 7 months in January 2020 to 21 years and 9 months in June 2021. This adjustment in average maturity and the maintenance of historically low interest rates have both contributed to the decline in DSTI ratios. The increase in the size of down payments, wherever possible, has also played a role: loan-to-value (LTV) ratios have fallen by 3.1 percentage points to an average of 82.4%.

These trends have led to a significant reduction in the share of new loans failing to comply with the recommendation: in July 2021, 20.9% of all new lending falling within the scope of the recommendation was non-compliant (Chart 1), which is very close to the 20% maximum flexibility margin designed to ensure credit access for borrowers purchasing their main residence (at least 80% of the maximum flexibility margin) and for first-time buyers (at least 30% of the maximum flexibility margin). **All major French banking networks now comply with the recommendation or are in the process of complying with it, and are converging towards the targeted composition of the maximum flexibility margin for borrowers buying their main residence, and especially first-time buyers**: between January and July 2021, the share of non-compliant new loans, excluding loans financing the purchase of main residences (i.e. mainly buy-to-let loans), fell from 7.8% to 5.2%, thus moving closer to the limit of 4%, whereas the share of non-compliant new loans excluding those to first-time buyers fell from 20.1% to 15.4%, compared with a limit of 14%[7].

[4] Recommendation No. R-HCSF-2019-1 of 20 December 2019 on developments in lending standards in the French residential real estate market, and Recommendation No. R-HCSF-2021-1 of 27 January 2021 on lending standards in the French residential real estate market: https://www.economie.gouv.fr/hcsf/les-recommandations-du-hcsf
[5] Loans falling within the scope of the recommendation (excluding bridge loans, loan transfers, loan renegotiations and loan consolidations).
[6] This figure does not take into account new housing loans where the maturity is between 25 and 27 years including the grace period tolerated by the recommendation.
[7] The share of new loans that do not comply with the recommendation, excluding loans for main residences, may not exceed (100-80=) 20% of the maximum flexibility margin, which is itself set at 20%, so 4% of total new lending. Similarly, the share of loans that are non-compliant, excluding loans to first-time buyers, may not exceed (100-30=) 70% of the maximum flexibility margin, or 14% of total new lending

Access to credit has remained strong and the real estate market has remained dynamic

This normalisation of lending standards has made housing loans safer for borrowers, without diminishing their access to credit. Despite the impact of the public health crisis, new lending has remained dynamic: in 2020 it amounted to EUR 192.7 billion, close to the record of EUR 193.0 billion reached in 2019, excluding loan transfers and renegotiations. The annual rate of growth in outstanding housing loans reached 6.7% in July 2021, despite the effects of the public health crisis (Chart 4). Similarly, the average loan size has continued to increase, reaching EUR 193,700 in June 2021, up 3.8% compared with a year earlier. After rising by 14 basis points between January 2020 and August 2020 to 1.31%, the average interest rate on new housing loans has begun to fall again, reaching a new record low in July 2021 of 1.12%. In addition, the recommendation has not penalised borrowers with modest incomes: the breakdown of new housing loans, excluding transfers and renegotiations, by income bracket has remained stable (Chart 6).

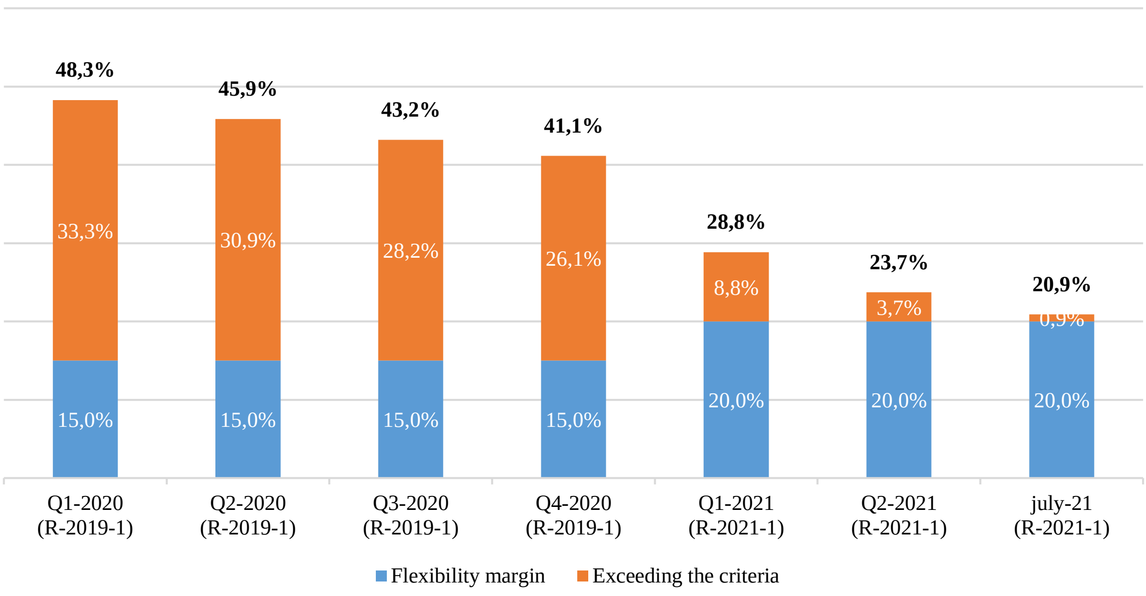
****

The gradual normalisation of lending conditions observed over recent quarters has strengthened the fundamentals of France's residential lending model and made it more robust. The vast majority of housing loans granted in France are backed by some form of surety (97.5% in 2020), usually a loan guarantee (63.8%) or a mortgage lien (27.2%), which mitigates the lender's losses in the event of a borrower default. The model is made even more robust by the dual selection process used for guaranteed loan applications, with both the lender and the loan guarantee company conducting their own separate assessment. In addition, nearly all housing loans in France carry a fixed rate of interest (99.4% of new lending in 2020), meaning that the interest rate risk is borne and managed by the credit institution while borrowers are protected in the event of a rate rise. By limiting DSTI ratios on housing loans and keeping loan maturities at reasonable levels, the recommendation ensures that banks can continue to guarantee loans and manage the associated interest rate risk.

It is crucial, therefore, that credit institutions comply with the criteria stipulated in the HCSF recommendation. The criteria will ensure the lasting resilience of the French residential lending model, while also guaranteeing widespread and sustainable access to housing credit. Consequently, and as planned since December 2020, the HCSF is transposing its recommendation into a legally binding standard, without modifying the criteria it contains.

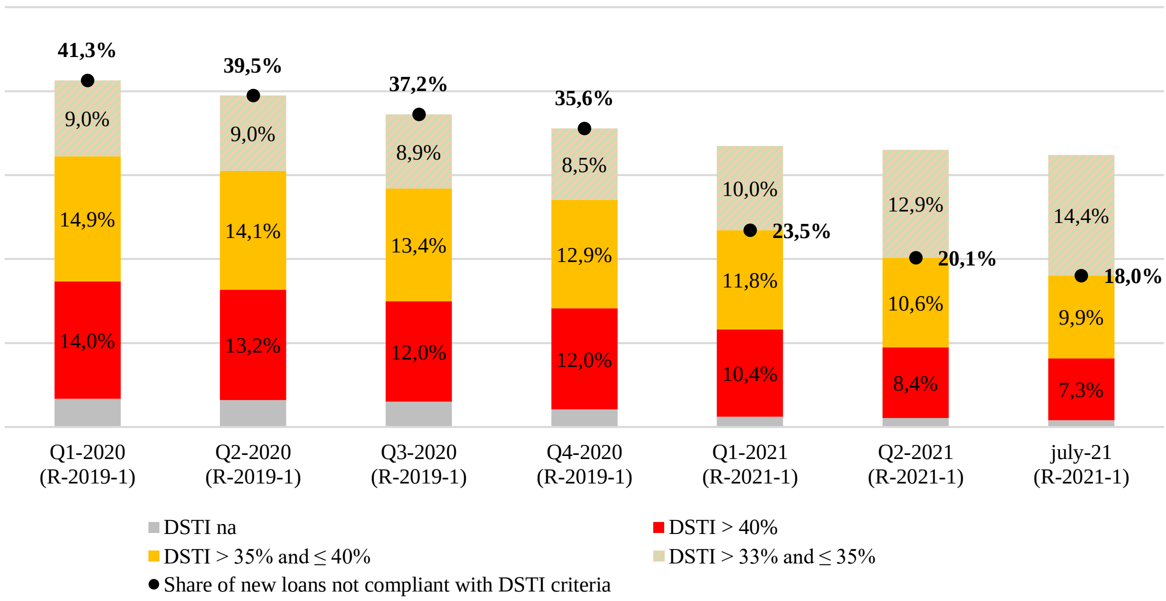
APPENDIX - CHARTS

1. New loans not compliant with HCSF recommendation (% of total new housing loans)



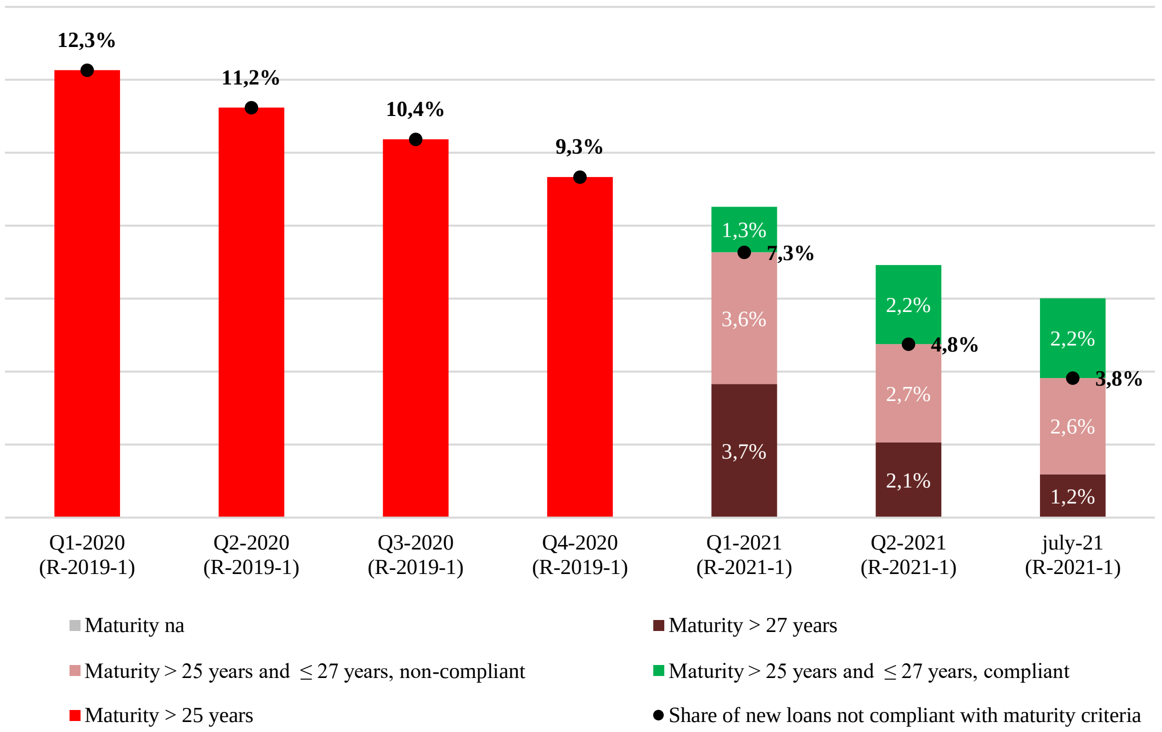
Source: CREDITHAB reporting (instructions 2020-I-02 and 2021-I-02); R-2019-1: recommendation No. R-HCSF-2019-1, R- 2021-1: recommendation No. R-HCSF-2021-1

2. New loans not compliant with DSTI ceiling (% of total new housing loans)



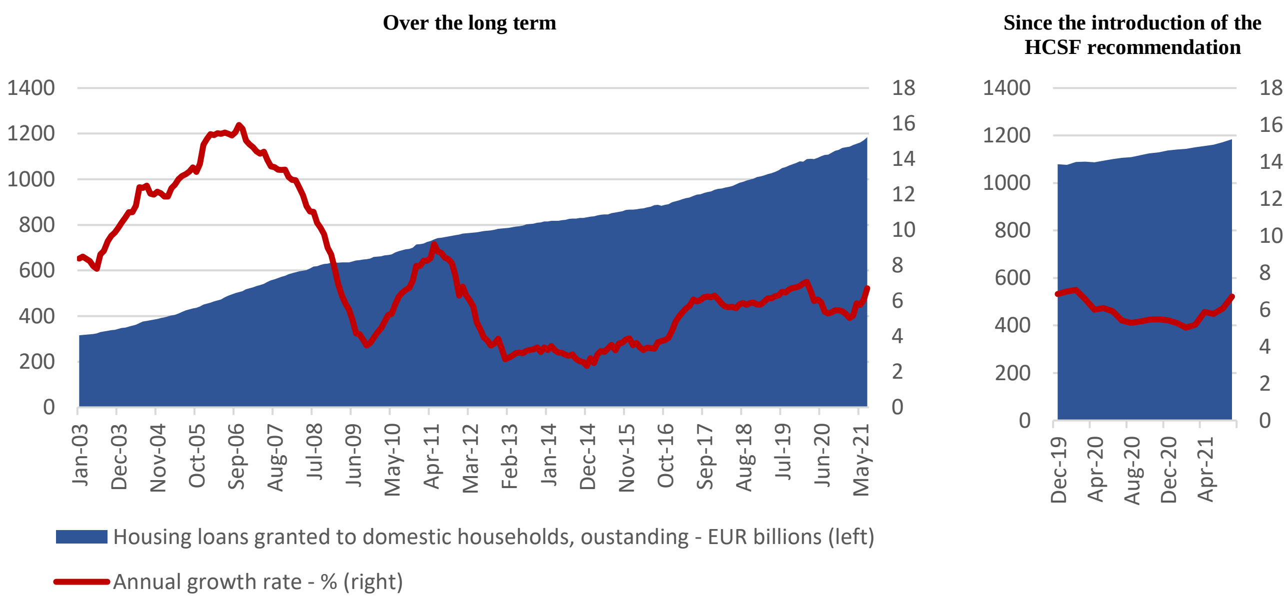
Source: CREDITHAB reporting (instructions 2020-I-02 and 2021-I-02); R-2019-1: recommendation No. R-HCSF-2019-1, R- 2021-1: recommendation No. R-HCSF-2021-1

3. New loans not compliant with maturity ceiling (% of total new housing loans)



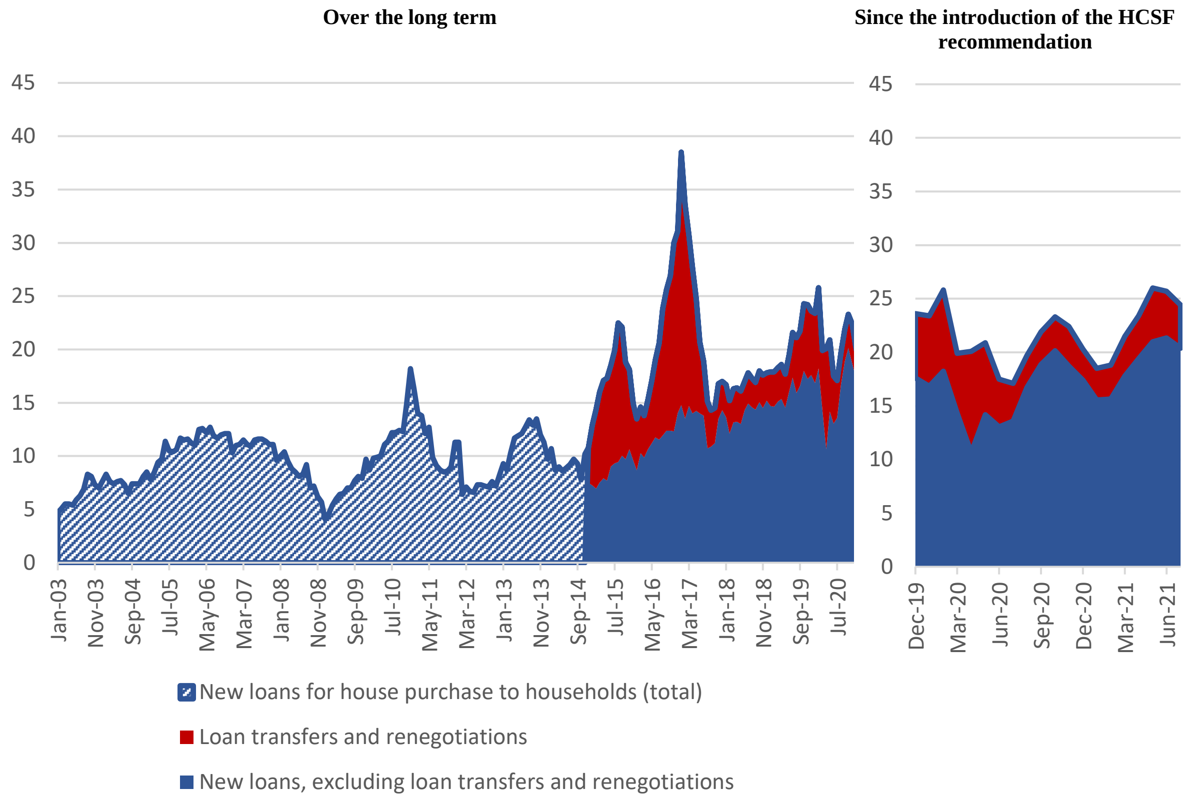
Source: CREDITHAB reporting (instructions 2020-I-02 and 2021-I-02); R-2019-1: recommendation No. R-HCSF-2019-1, R-2021-1: recommendation No. R-HCSF-2021-1

4. Outstanding housing loans to domestic households (EUR billions, left-hand scale) and annual growth rate of outstanding stock (%, right-hand scale)



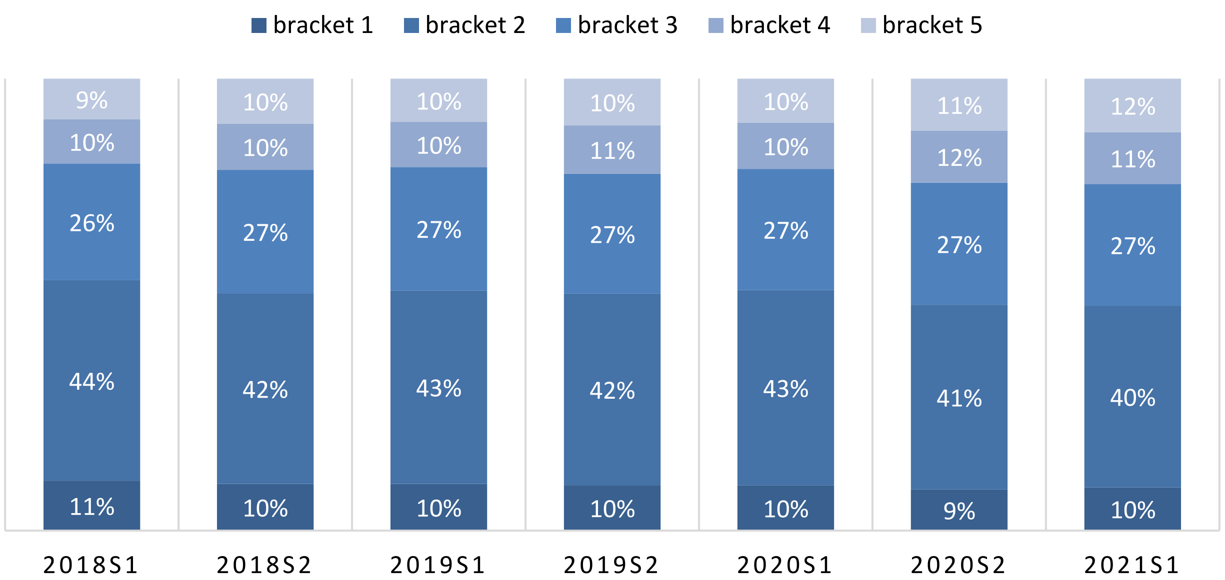
Source: Banque de France

5. New housing loans to domestic households (in EUR billions, left-hand scale)



Source: Banque de France

6. Breakdown of new housing loans (in number of loan applications) by income bracket, excluding transfers and renegotiations



Source: Banque de France
Notes: The income brackets are defined as follows: €0 to €20,000 (Bracket 1); €20,000 to €40,000 (Bracket 2); €40,000 to €60,000 (Bracket 3); €60,000 to €80,000 (Bracket 4); over €80,000 (Bracket 5)