New mortgage regulations in Romania

Rethinking the economics of owning versus renting a home

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After more than a year of speculation and for the first time in more than a decade, the National Bank of Romania (NBR) reintroduced limits for the maximum indebtedness levels (relative to net earnings) for individuals/families seeking out consumer or mortgage loans. These debt-service-to-income (DSTI) ratios will become 40% for RON loans and 20% for hard currency starting 2019; as an exception, banks can ignore these limits for 15% of their new clients, as well as for first-home buyers, who can benefit from a maximum indebtedness level of 45% for RON loans. Currently, DSTI could move significantly above 60% in some cases.

While Colliers has no vested interest in the residential segment (*), given the bellwether effect that this market has for the Romanian economy and the consumers especially, we believe it is important to take a closer look at the impact that these changes will bring to the market.

WHERE IS THE MARKET RIGHT NOW?

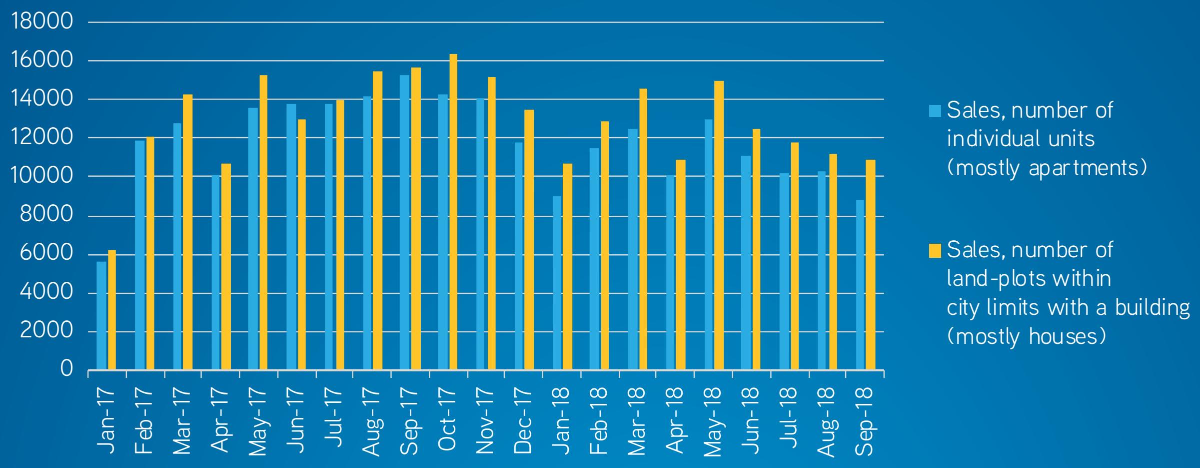
As a first point, asset price growth was already cooling in 2018, moving towards a less-than-stellar c.5% YoY mid-year, amid an abundance of supply in most of the country (something which is likely to extend into 2019).

We have already argued in 2018's market report, as well as in an analysis for the Romanian Association of Financial Banking Analysts (available here in Romanian), why we believe an asset bubble is not at play currently and the fact that residential price growth is even more behind wage expansion supports our view. This doesn't necessarily exclude an upcoming correction, especially if a negative global economic event unfolds (something which we do not take into account for the next couple of years, though, admittedly, there are ever more things that can go wrong).

Moreover, amid the new DSTI limitations that will likely impact demand, it is important to note that residential sales were already contracting in recent months. Local media has been in a frenzy following the reported drop of apartment sales by over 40% YoY in September, but there are some possible explanations. **The final part of 2017 and first part of 2018 seem quite strong (data series begins, unfortunately, in January 2017) and this might be due to a sort of a "fear of missing out" effect, as Romanians took note of the sharp rise in interest rates and flocked to buy an apartment**, leading to a subsequent big decline following mid-2018. Also, in the first 9 months of the year, flat sales dropped by a less impressive 13%, while at the same time, the number of houses sold was rather unchanged (-5% year-to-date).

** Colliers International Romania does not have a residential department, so it has no direct interest; indirect ties with the residential segment arise mostly from the land and valuations departments.*

HOUSING SALES DIP NOT AS DRAMATIC AS SEEMS AT FIRST GLANCE

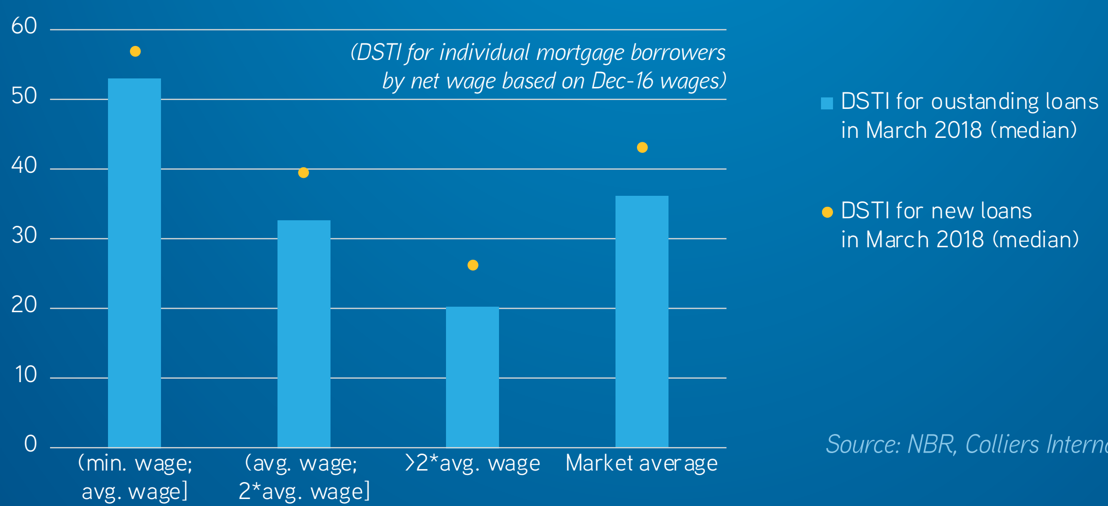


Source: National Agency for Cadastre and Real Estate Publicity, Colliers International Romania

So, given the somewhat constrained market, how impactful will this regulation be for the market? The short answer is that it will be relevant, but maybe a bit less than might seem at first sight. According to the central bank, the current average DSTI for the individual mortgage owner is about 47% (for a family with two children, it is close to the new limit, as per NBR data). A drop to 40% from 47% would mean that such a person with a net income of RON3,000/month can borrow close to a maximum of 190,000 RON for a 30-year loan versus over 220,000 RON currently.

An interesting set of data from the central bank offers a possible argument for the somewhat dramatic DSTI ratio change, namely the fact that banks had become much more lenient for new loans than in the past (the DSTI ratio for new loans for low-earners had increased by over 10 percentage points between March 2017 and March 2018). It also underscores why **we expect the lower to medium price brackets of the residential market to suffer most, as people with low or average incomes were already well above the 40% threshold for mortgages.**

BIG IMPACT FOR PEOPLE WITH LOW-AVERAGE INCOME, NOT SO MUCH FOR THE SECOND HALF OF THE MARKET



Source: NBR, Colliers International Romania

It is important to note that Romania is not reinventing the wheel with this change, though it does seem a bit harsher than what we are seeing in neighbouring countries, maybe as the memory of the past crisis still haunts the central bank. Czechia just imposed a 45% DSTI limit for mortgages as of October 2018, while Poland has a recommendation for banks of a maximum of 40% for people with low income and 50% for the rest.

As a conclusion, we see several material changes stemming from the new regulation. However, contrary to what the mainstream media has been presenting in the recent period, **we don't expect a generalized (and significant) price drop. Still, 2019 is likely to become a year of rebalancing of expectations from developers, banks and potential buyers.** As an observation, we do not take into account a rebirth of a global economic turmoil event that could worsen the outcome of the new regulations.

SHORT-TERM IMPACT

- In another example of the fear of missing out effect, we expect to see a resurgence in buying activity in the final part of the year, but we don't expect this to stoke prices again; developers will be rather glad to cash in on their current supply given the prospect of curbed demand starting 2019;
- We expect residential projects that have not started to wait a bit until the fog clears, at least until mid-2019, especially given the hefty delivery pipeline already underway; furthermore, developers that have not seen good pre-sales might drag out the delivery date a bit.

MEDIUM-TO-LONGER TERM IMPACT

- In terms of prices, the impact will be uneven, geared more towards the low and medium-low segments of the residential market; climbing up the price ranges, the impact will be dimmer and might be absent altogether (as suggested by DSTI ratios for those with below-average income);
- We also see lower effect on valuations for apartments in central locations or very good connectivity to business hubs than for apartments/houses at the periphery of cities;
- The price difference between new and old apartments (not in central locations) will become much deeper than it is currently;
- If possible from the developers' side, we expect those who can hand out loans to become more relevant;
- As it will become harder to own a home, rents will grow materially (especially in the first couple of years); currently, Romania has the highest home ownership ratio in the EU, at well over 90%, but this will gradually decline to more 'European' levels over time;
- Indirectly, a reduced home ownership ratio could help improve Romania's internal labour force mobility, which can actually help GDP growth over the longer term;
- All in all, in terms of consumer education, this new regulation should prove positive for the medium term, even though it will adversely impact the market for a couple of years.

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