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BANQUE DE FRANCE
EUROSYSTÈME

Financial stability and financial system

Home lending standards have returned to 2007-08 levels

Against a backdrop of persistently low interest rates, the French residential real estate market proved extremely dynamic in 2018. Total outstanding housing loans exceeded the EUR 1,000 billion mark at the end of the year.

Due to the structural features of the French market (preponderance of fixed-rate and guaranteed loans), credit risk remains limited. Nonetheless, lending standards have gradually been eased and in some cases are back in line with the levels observed in 2007-08. This is contributing to the rise in borrowing, and helping to push prices up faster than household income. The easing of lending standards concerns all categories of borrower. However, given that a high share of new loans are to borrowers who already own property and who have higher earnings and financial resources, the risks appear to be contained, as demonstrated by the low rate of loan delinquencies.

The easing of lending standards and trajectory of household indebtedness raise concerns as to the sustainability of recent developments. As a result, the *Autorité de contrôle prudentiel et de résolution* (ACPR – Prudential Supervision and Resolution Authority) and Banque de France are keeping a close eye on the risks linked to the financing of the residential real estate market.

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JEL codes:
G21, R21,
R31

EUR 170,200
average size of a housing loan
(increase of 5.5% versus 2017)

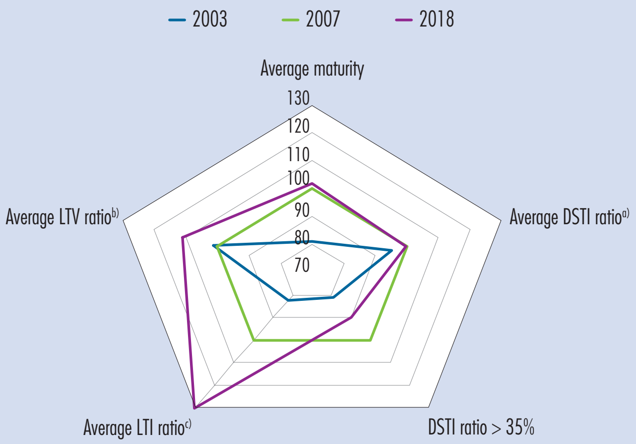
19.9 years
average maturity of a housing loan
(increase of 11 months versus 2017)

30.1%
average debt-service-to-income (DSTI) ratio (29.7% in 2017)

5.2 years of income
average loan-to-income (LTI) ratio for housing loans in 2018
(increase of 4 months versus 2017)

87.3%
average loan-to-value (LTV) ratio at origination
for housing loans (87.0% in 2017)

Lending standards
(2007 = 100)



Source: ACPR.
a) DSTI ratio = debt-service-to-income ratio.
b) LTV ratio = loan-to-value ratio.
c) LTI ratio = loan-to-income ratio.
Note: The average LTI ratio was 4 years in 2007. In 2018 it was 30% higher at 5.2 years.

1 A dynamic real estate market in a context of low interest rates

Buoyed by historically low interest rates, levels of debt in the private non-financial sector remain high in France. Household debt in particular has risen steadily since the start of the 2000s, and as at 31 December 2018 was equivalent to 70% of GDP. The increase observed since the crisis contrasts starkly with the stabilisation or decline generally seen in the main neighbouring European economies.

In the residential real estate market in particular, 2018 proved to be another very dynamic year: the number of transactions hit an all-time high of 970,000, well above the average of 788,000 observed since 2000, and the Notaries-INSEE second-hand dwellings price index rose by 3.2% in mainland France (rises of 4.2% in the Île de France region and of 2.8% in the rest of France).

Against this favourable backdrop, new lending for house purchases amounted to EUR 203 billion over the year, far exceeding the average since 2003 (EUR 145 billion), although down 26% versus 2017. This drop is attributable to the sharp fall in loan transfers[1] (down 67%), which went from 24% of new lending in 2017 to 9% in 2018 (see Chart 1).

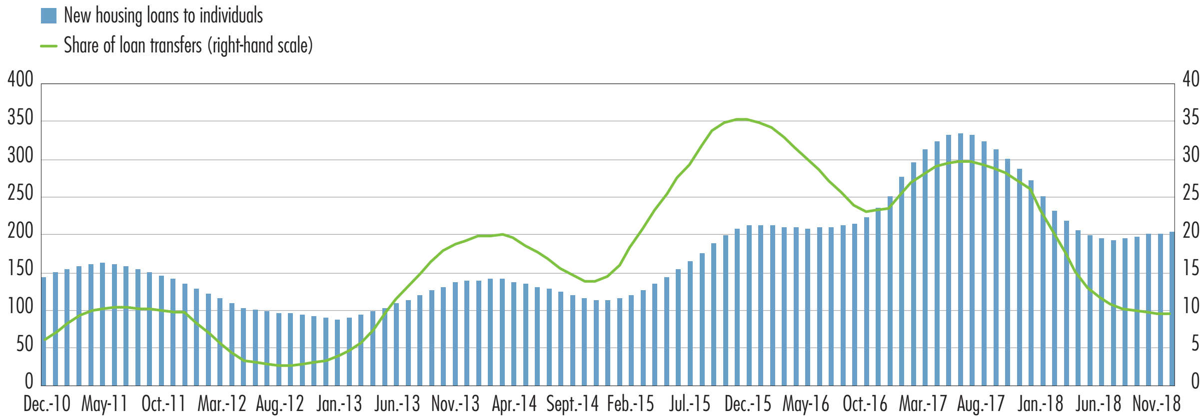
In parallel, total outstanding housing loans rose to above the EUR 1,000 billion mark in 2018 (EUR 1,010 billion as at 31 December 2018).

2 The structural features of the market limit the risk of household defaults, despite the easing of lending standards

In the residential real estate market, French banks continue to lend almost exclusively at fixed interest rates (98.5% of new lending in 2018), thereby limiting the risks to households of a possible rise in rates. In addition, nearly all of these loans (96.9%) are backed by some form of surety, mortgage lien or guarantee, which limits the loss incurred by the bank in the event of a borrower default. Unlike in other countries, French banks also have a policy of granting loans based on the borrower's solvency (which is notably measured using the debt-service-to-income (DSTI) ratio) and not on the value of the property.

C1 New housing loans to individuals and share of loan transfers

(EUR billions and %)



Sources: ACPR (monthly monitoring of new housing loans) and Banque de France.

1 A loan transfer is a transaction whereby a borrower takes out a new loan with a bank to repay a loan previously taken out with another bank.

Nevertheless, the issue of changes in lending standards is still of crucial importance: the gradual easing of certain standards is in part behind the current strength of the home lending market, in a context where house prices are rising faster than household income. In addition, the decline in interest rates has not been accompanied by a fall in debt service payments: the latest available surveys suggest that most households still think their debt repayments are high.

The rise in average loan size is being driven by existing homeowners

The average size of a loan at origination has risen almost constantly since 2009. In 2018 it increased by 5% to EUR 170,187, outstripping the pace of growth in property prices (see Chart 2).

The rise is mainly attributable to existing homeowners (see Chart a in the appendix) who tend to have higher incomes and, on average, take out larger loans than other categories of borrower: in 2018, the average loan size for existing homeowners rose by 6% to EUR 196,856. Average loan sizes increased to a lesser extent for other borrower categories (rises of 1.7% for first-time buyers and 1.3% for buy-to-let borrowers) and even declined in the case of loan transfers (down 3.2%). In Île de France, the average loan size rose almost twice as fast as in the rest of France (increases of 8.6% and 4.6% respectively), reflecting much stronger growth in house prices in the region.

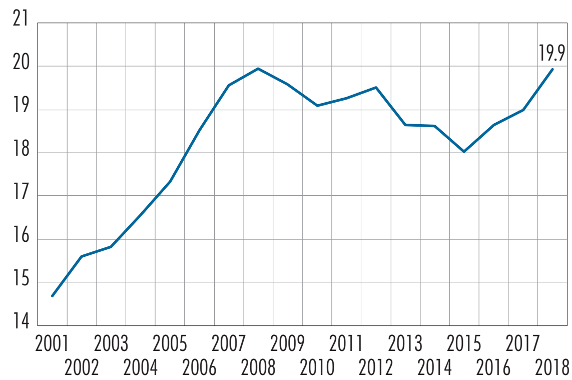
The average loan maturity is back in line with 2008

The average loan maturity increased for the third year running to a total of 19.9 years, which is back in line with 2008's level and up 11 months on 2017 (see Chart 3).

The rise in average maturity, excluding loan transfers, has been driven primarily by existing homeowners (rise of 5 months to 20.8 years) and first-time buyers (rise of

C3 Average housing loan maturity at origination (excluding bridge loans)

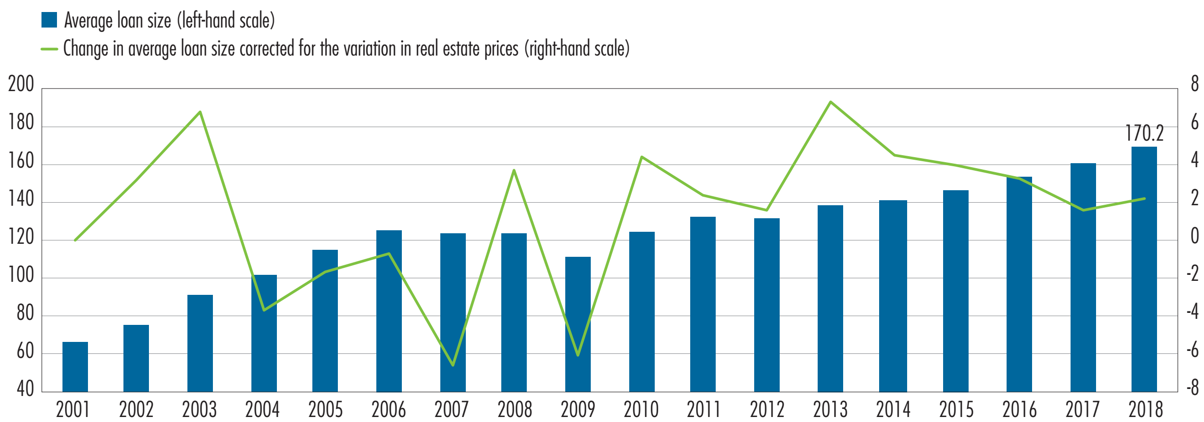
(number of years)



Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.

C2 Average loan size and change compared with real estate prices

(EUR thousands and % change)



Sources: ACPR (annual survey of housing finance and monthly monitoring of new housing loans) and INSEE (Notaries-INSEE second-hand dwellings price index, mainland France).

6 months to 22.1 years) (see Chart b in the appendix). The initial maturity of loan transfers is generally nearly three years lower than the average, due to the fact that the principal has already been partially repaid.

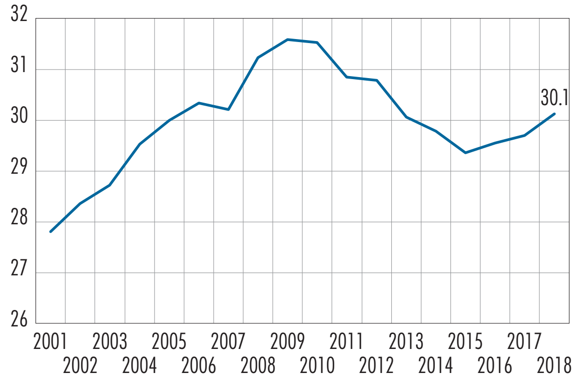
DSTI ratios remain contained

The average DSTI ratio[2] rose slightly for the third straight year, reaching 30.1% in 2018 (up 40 basis points on 2017). It nonetheless remains below the level seen in 2009 (31.6%) (see Chart 4). Despite the 5% increase in the average loan size, the average DSTI ratio has only deteriorated to a limited extent (increase of 1.3%), as low interest rates and the relatively flat yield curve have allowed borrowers to extend their loan maturities without significantly increasing their debt repayment costs.

The rise in the DSTI ratio is largely attributable to the increase in the ratios for existing homeowners (up 21 basis points) and buy-to-let borrowers (up 47 basis points). In addition, DSTI ratios increased three times faster in the Île de France region than in the rest of France (up 86 basis points to an average 31.3%, compared with growth of 33 basis points elsewhere).

C4 Average DSTI ratio at origination for beneficiaries of housing loans

(%)

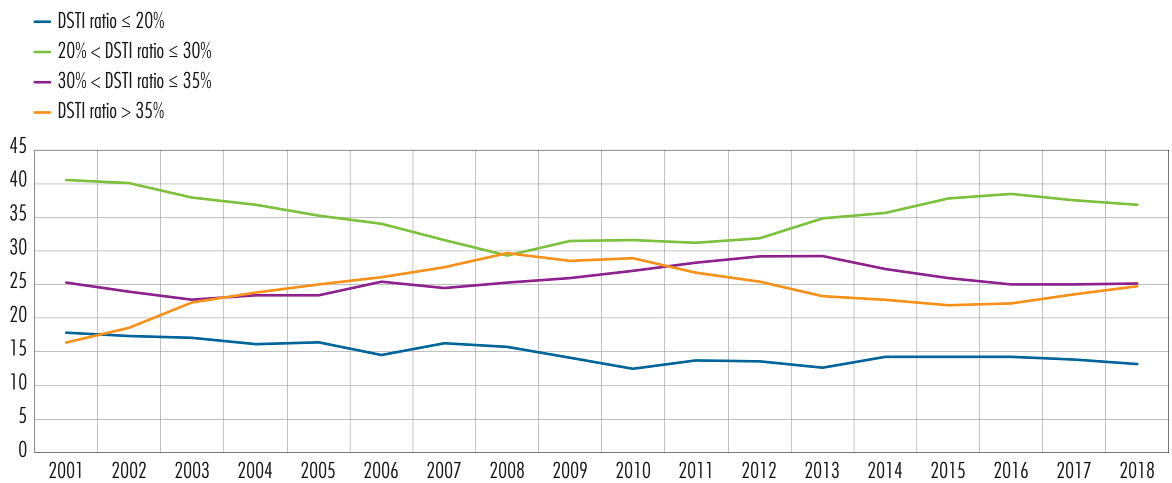


Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.
Note: The DSTI ratio is the ratio of a borrower's regular outgoings (including all loan repayments) to his/her total income.

The increase in the average DSTI ratio mainly reflects a rise in the share of loans with a ratio in excess of 35% (see Chart 5). This in turn is largely due to existing homeowners (see Chart d in the appendix).

C5 Breakdown of new lending by DSTI ratio

(%)



Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.
Note: The DSTI ratio is the ratio of a borrower's regular outgoings (including all loan repayments) to his/her total income.

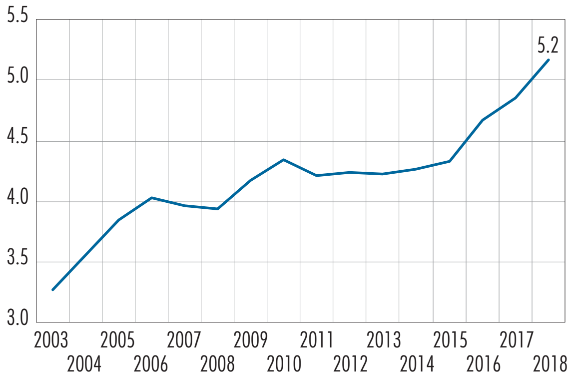
2 The debt-service-to-income (DSTI) ratio is the ratio of a borrower's regular outgoings (including all loan repayments) to his/her total income.

Rapid rise in loan-to-income (LTI) ratios

The average LTI ratio[3] increased sharply for the third year running, reaching 5.2 years in 2018 (up 4 months on 2017), which is the highest level since 2003 (see Chart 6). Excluding loan transfers, the rise is primarily attributable to existing homeowners and first-time buyers (see Chart in the appendix), whose LTI ratios increased by 2 months to 5.5 years and 5.6 years respectively.

C6 Average LTI ratio at origination for beneficiaries of housing loans

(number of years of income)



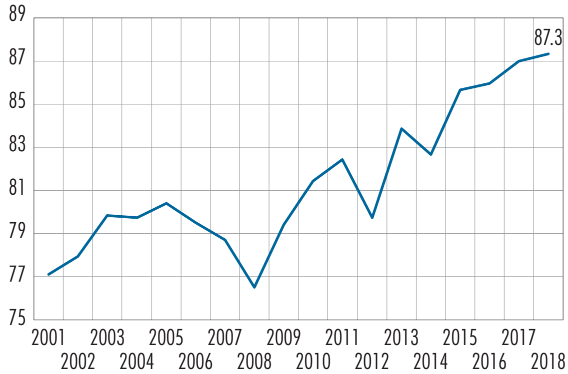
Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.
Note: The LTI ratio is the ratio between the loan principal at origination and the borrower's annual income at the same date.

Loan-to-value (LTV) ratios at origination have increased, but current LTV ratios remain stable

The average LTV ratio at origination[4] increased for the fourth consecutive year in 2018 (up 30 basis points), reaching an all-time high of 87.3% (see Chart 7). Excluding loan transfers, this growth is principally linked to first-time buyers (see Chart f in the appendix), whose average LTV rose by 190 basis points to 90.4%. LTV ratios nonetheless remain a secondary lending criteria for French banks, which prefer to focus instead on the borrower's ability to repay.

C7 Average LTV ratio at origination on housing loans

(%)

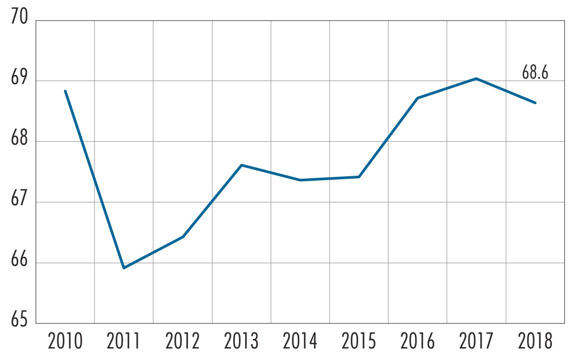


Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.
Note: The LTV ratio at origination is the ratio between the loan principal and the purchase price of the property.

In addition, the average current LTV ratio, which is the ratio of the outstanding principal of the loan to the market value of the financed property, is lower than the average LTV at origination. It has remained stable since 2016 at around 69% (see Chart 8). This is attributable to two factors: nearly all housing loans are instalment loans, and prices are once again moving upwards.

C8 Average current LTV ratio on housing loans

(%)



Source: ACPR, annual survey of housing finance.
Note: The current LTV ratio is the ratio between the outstanding principal of the loan and the market value of the financed property.

3 The loan-to-income (LTI) ratio is defined as the ratio between the loan principal at origination and the borrower's annual income at the same date. It shows the number of years of income needed to repay the housing loan. Banks participating in the annual housing finance survey are not currently required to submit these data. Instead, the figures are estimated by the ACPR.

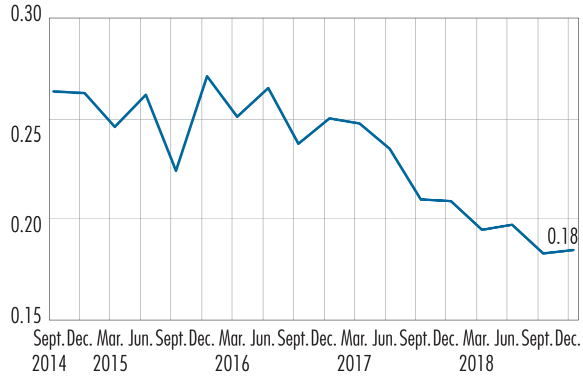
4 The loan-to-value (LTV) ratio at origination is the ratio between the loan principal and the purchase price of the property.

3 Loan delinquencies remain limited

Despite the observed easing in lending standards, loan delinquencies remain low in the French home lending market, both in terms of stocks (1.3% of outstanding loans were non-performing as at 31 December 2018, down 13 basis points versus 2017; see Chart 9) and flows (only 0.18% of outstanding loans were downgraded to non-performing status in the fourth quarter of 2018, the lowest rate ever seen; see Chart 10). The cost of risk remained negligible at 3 basis points in 2018, which is lower than the average level observed since 2006 (5 basis points).

C10 Quarterly default rate on housing loans

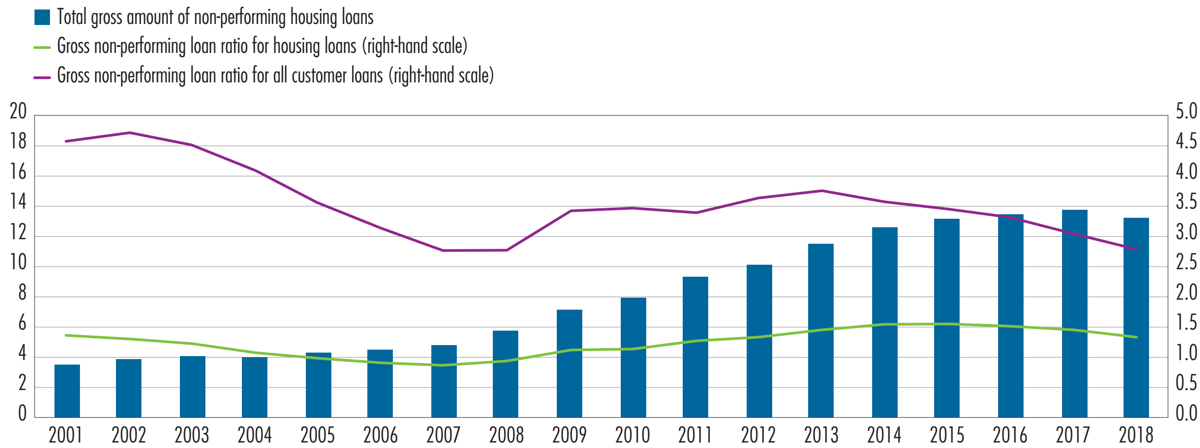
(% of previous quarter's stock of performing loans)



Source: ACPR, COREP data.

C9 Annual change in the stock of non-performing housing loans

(EUR billions and %)



Source: ACPR, annual survey of housing finance and BAFI/SURFI data.

BOX

Overhaul of the monthly monitoring of new housing loans

The monthly collection of statistics on new housing loans (CREDITHAB table) was introduced under ACPR Instruction No. 2011-14 and has been carried out for a number of years. However, it recently became necessary to update the methodology used. At the end of 2016, as part of its work on the analysis of real estate risk, the European Systemic Risk Board (ESRB) published a recommendation (No. 2016-14) aimed at closing the gaps in the data on residential and commercial real estate. Although this text required only limited changes to be made to the CREDITHAB table, the data collection also needed to be overhauled to meet the requirements of the *Haut Conseil de stabilité financière* (High Council for Financial Stability) regarding the monitoring of risks in housing finance.

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On 26 March 2019, the ACPR College adopted Instruction No. 2019-08 extending the coverage of the monthly survey. The main changes were as follows:

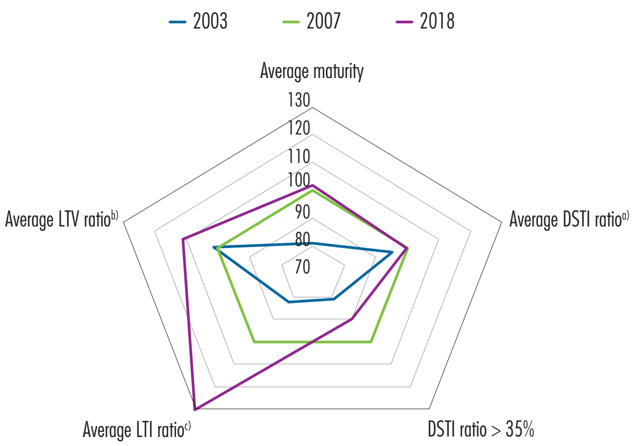
- addition of a number of loan sub-categories: renegotiations (in addition to loan transfers), separation of Paris from the rest of the Île de France region;
- addition of several indicators: breakdown of new lending by amortisation and guarantee type, borrower income and LTI ratio, collection of detailed statistics on flows of loans with a DSTI ratio of over 35% and an LTV ratio of over 100%, flows of defaults by borrower cohort;
- breakdown of new lending by amount (and no longer by the number of contracts) according to different frequencies;
- use of the definitions and methods of calculation set out in the ESRB recommendation (notably regarding the frequency of the different breakdowns).

Ultimately, the easing of lending standards remains a gradual process and, at this stage, appears to be on the whole contained. At the same time, the structural features of the French residential real estate market are helping to limit any deterioration in household credit risk.

That said, aside from the average DSTI ratio, which remains at its 2007 level (or indeed slightly below for new loans with a DSTI ratio in excess of 35%), all lending standards have returned to (e.g. loan maturities) or now exceed (e.g. average LTI ratio or LTV at origination) their 2007-08 levels (see Chart 11). This easing of lending standards, coupled with the trend in household indebtedness, raises questions as to the sustainability of the current situation[5] (see *Assessment of risks to the French financial system*, June 2019)[6] and its long-term implications for the stability of the financial system. This is notably why, as a preventive measure, the *Haut Conseil de stablité financière* (High Council for Financial Stability) recently increased the countercyclical capital buffer on two separate occasions. In this context, the ACPR and Banque de France are keeping a close eye on the risks linked to the financing of the residential real estate market.

C11 Lending standards

(2007 = 100)



Source: ACPR, annual survey of housing finance and monthly monitoring of new housing loans.
a) DSTI ratio = debt-service-to-income ratio.
b) LTV ratio = loan-to-value ratio.
c) LTI ratio = loan-to-income ratio.

5 In particular its impact on household consumption since, according to INSEE, the share of household income that goes towards "essential spending" has risen from around 27% in 2000-05 to close to 30% since 2013 (29.2% in 2018). This is mainly due to the rise in housing-related costs, which have accounted for more than 78% of "pre-committed" spending since 2013 (78.3% in 2018) compared with 74% at the start of the 2000s.

6 *https://publications.banque-france.fr/evaluation-des-risques-du-systeme-financier-juin-2019*

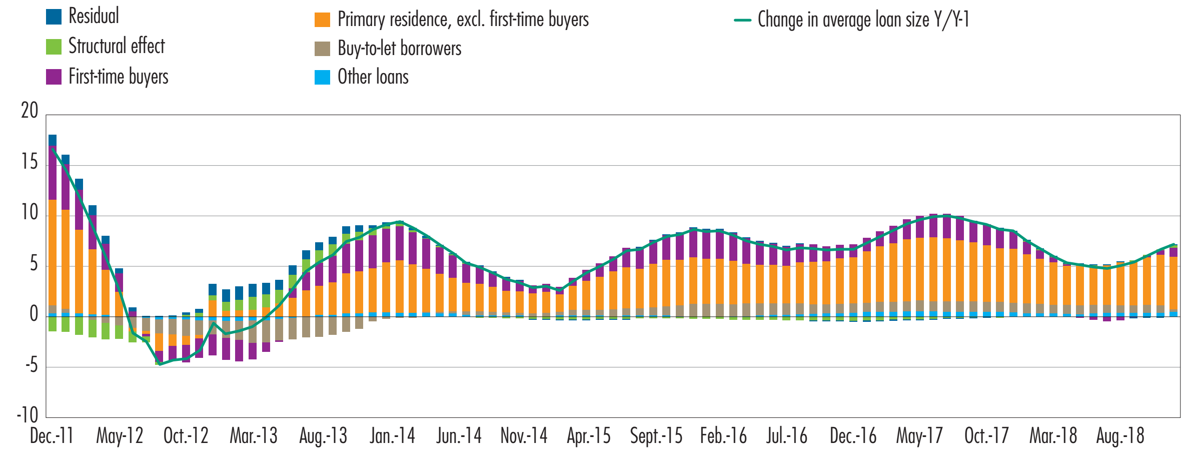
Appendix
Analysis of the changes in lending standards

The "contributions" of the different segments measure the share of the change in a given average risk indicator (e.g. average loan size) that is attributable to the change in the indicator for that particular segment. The "structural effect" measures the share of the change in the average indicator that is attributable to the change in the structure of new lending (higher or lower weight of segments with a high/low indicator value). The "residual" effect corresponds to the change in the average indicator that cannot be attributed to the two previous effects.

Average loan size

Ca Contribution of the different market segments (excluding loan transfers) to the change in average loan size

(EUR thousands)

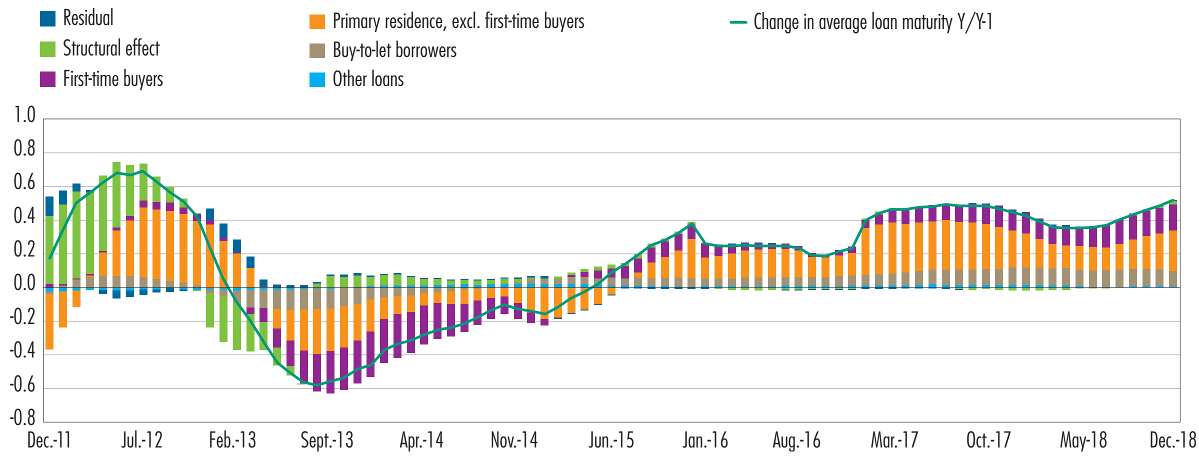


Source: ACPR, monthly monitoring of new housing loans.
Note: Average data over a rolling 12-month period.

Average initial loan maturity (excluding bridge loans)

Cb Contribution of the different market segments (excluding loan transfers) to the change in average maturity

(number of years)

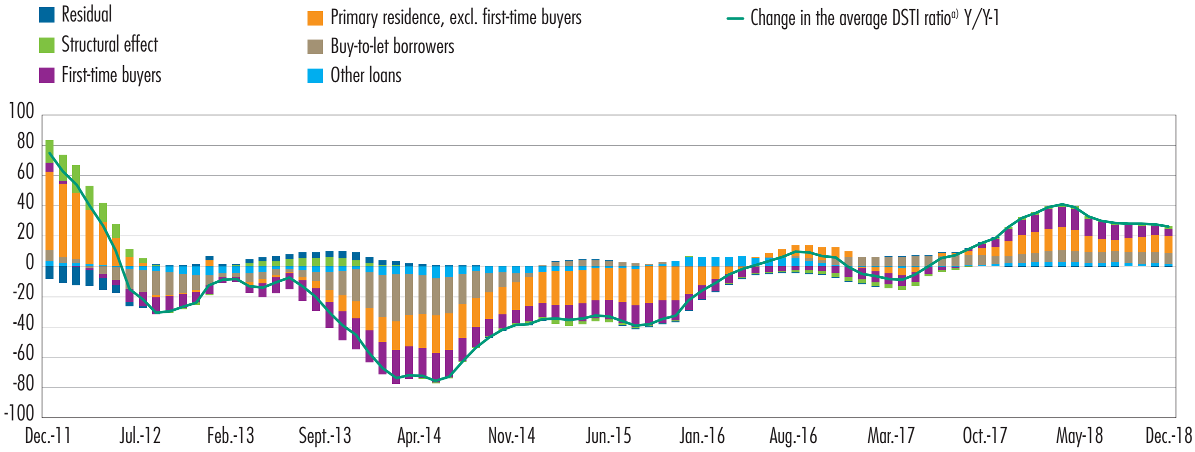


Source: ACPR, monthly monitoring of new housing loans.
Note: Average data over a rolling 12-month period.

Average DSTI ratio

Cc Contribution of the different market segments (excluding loan transfers) to the change in the average DSTI ratio

(basis points)

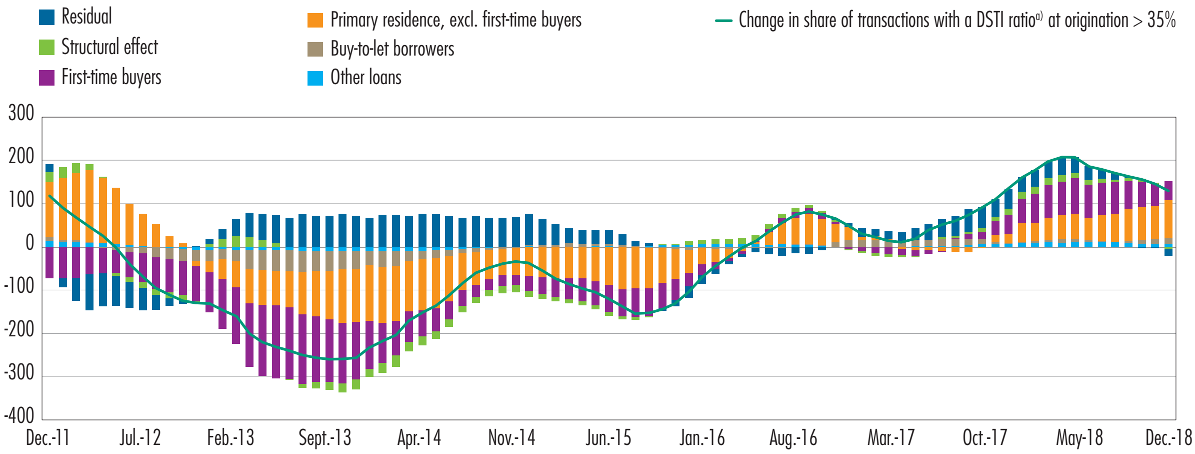


Source: ACPR, monthly monitoring of new housing loans.
a) DSTI ratio = debt-service-to-income ratio.
Note: Average data over a rolling 12-month period.

DSTI ratio of over 35%

Cd Contribution of the different market segments (excluding loan transfers) to the change in the share of loans with a DSTI ratio of over 35%

(basis points)

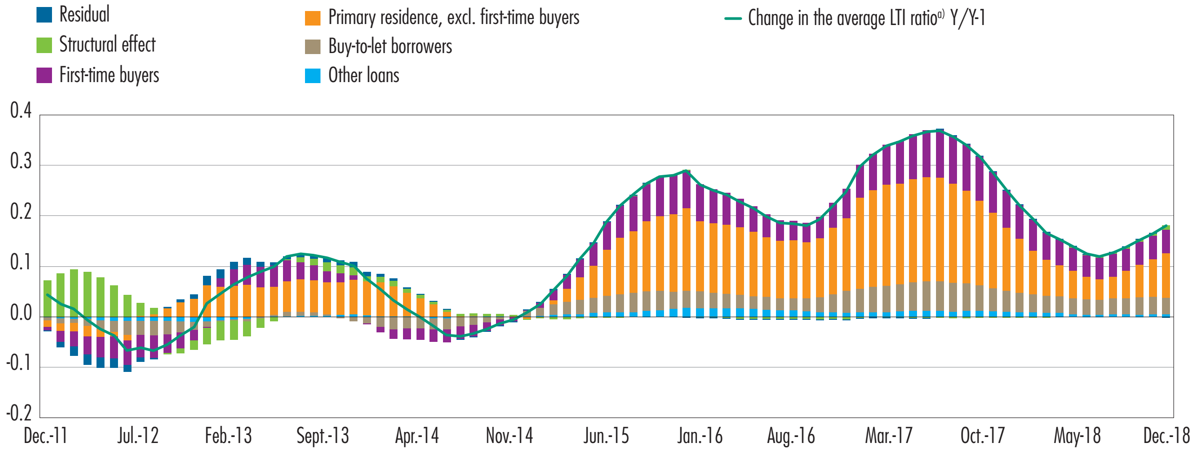


Source: ACPR, monthly monitoring of new housing loans.
a) DSTI ratio = debt-service-to-income ratio.
Note: Average data over a rolling 12-month period.

Average LTI ratio

Ce Contribution of the different market segments (excluding loan transfers) to the change in the average LTI ratio

(number of years)

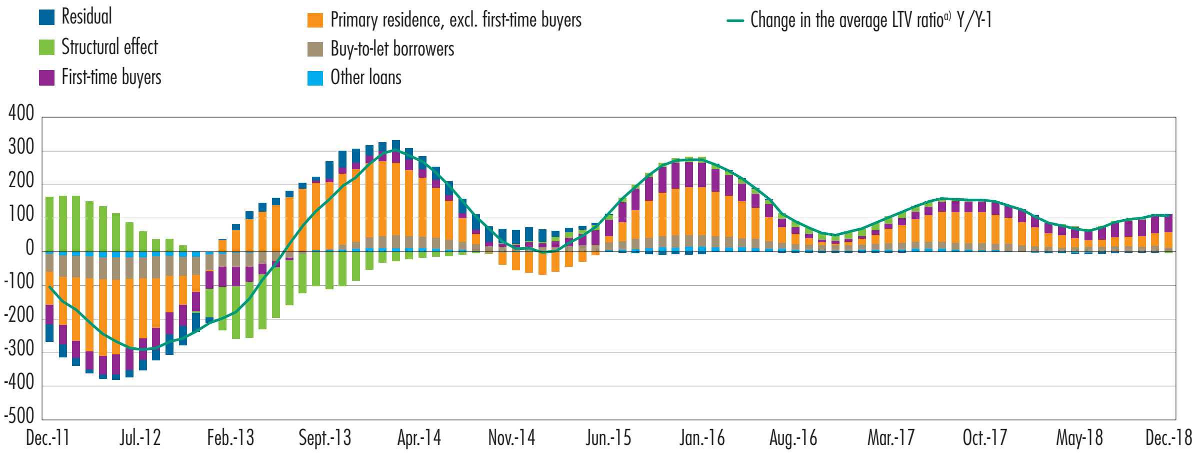


Source: ACPR, monthly monitoring of new housing loans.
a) LTI ratio = loan-to-income ratio.
Note: Average data over a rolling 12-month period.

Average LTV ratio at origination

Cf Contribution of the different market segments (excluding loan transfers) to the LTV ratio at origination

(basis points)



Source: ACPR, monthly monitoring of new housing loans.
a) LTV ratio = loan-to-value ratio.
Note: Average data over a rolling 12-month period.

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