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Analyses et Syntheses

Housing finance in France in 2014

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CONTENTS

Overview

- 2014 saw a continuation of the gradual downward drift in residential property prices which began in 2012: prices fell by a further 2.4% nationwide, although the drop was more marked in the rest of France (-2.5%) than in the Île de France region (-2%) and in Paris (-2.2%). Trends in transaction volumes varied over the year: purchases of existing dwellings picked up in the first half of 2014, but then declined again over the remainder of the year (-3.5%), and this downward trend accelerated in the first quarter of 2015 (-4.8% at end-March); in contrast, transactions in the new housing market have rebounded markedly since the first quarter of 2014.

- Against this backdrop, new residential lending by French banks contracted by close to 19%, despite the ongoing decline in loan rates, which have fallen to all-time lows. At the same time, the total outstanding stock of residential loans continued to rise, albeit at a very modest pace of +2.3%, which is lower than the rate seen in 2013 (+3.9%) and closer to that observed at the end of the 1990's real-estate crisis.

- Overall, an analysis of banks' risk exposure on residential loans in France in 2014 shows no particular cause for concern: new residential lending, as well as stocks of existing lending, are still primarily comprised of fixed rate loans, and nearly all outstanding lending is secured, the majority by a credit institution or an insurance company. A number of indicators suggest that banks are tending to shift their focus more towards wealthier customers who, in principle, are lower-risk: despite the ongoing rise in the average loan amount, which appears to have disconnected from the trend in property prices since 2012, the average initial loan maturity and average debt service ratio have fallen since the crisis. According to estimates by the *Autorité de Contrôle Prudentiel et de Résolution* (ACPR – Prudential Supervision and Resolution Authority), average borrower income has increased by 28.1% since 2003.

- Loan approval decisions are still mainly based on the solvency of the borrower rather than on the value of the financed property, and banks appear to be relatively protected against any shock to prices. The average LTV ratio for outstanding residential loans remained unchanged at 52.3% between 2013 and 2014, as the ongoing decline in property prices was offset by an acceleration in the rate of amortisation for outstanding loans, in turn stemming from the decline in initial maturities and in interest rates on new loans. On average, prices would need to drop by just over 47% for the value of financed properties to fall below the remaining principal of outstanding loans.

- An individual analysis of the surveyed banks shows that the overall risk profile for the group is moderate. In the case of new lending in particular, the laxer credit standards applied by certain banks are generally offset by the tighter standards reported by others.

- Despite this overall favourable appraisal, a number of issues need to be highlighted:

  - After declining markedly in 2014, loan transfers have rebounded sharply since the third quarter of 2014, climbing to their highest level (in absolute and relative terms) since January 2010. Similarly, data collected by the ACPR show that certain banks have seen a sharp rise in loan renegotiations over the period. These trends, which reflect intense competition between banks, temporarily boost income due to the early repayment and renegotiation fees charged to customers, and generally have a more lasting positive impact on borrower solvency. However, they also raise doubts over whether the pricing of new loans is sufficiently high, and over the future profitability of banks' residential loan book.

  - Gross non-performing loans have been rising steadily since the crisis and account for a growing proportion of total outstanding housing loans – although this share is still smaller than in 2001, and smaller than the ratio of non-performing loans to non-bank borrowers. In parallel, the cost of risk on residential loans rose to its highest-ever level in absolute terms in 2014. As a ratio of total outstanding loans, it remains below its 2009 high, and below the average cost of risk ratio for the banking sector as a whole; however the ratio for residential lending has been rising since 2011, while for overall bank lending it has tended to decline. The rise in defaults on residential loans appears to stem primarily from the first-time buyer segment, where the gross NPL rate and cost of risk have quadrupled and tripled respectively since 2010. That said, an economic analysis reveals that, for the time being at least, French banks and loan guarantors have more than sufficient capital and similar resources (guarantee funds, technical reserves, etc.) to cover their cost of risk on residential loans.

- A large share of the new residential lending of two of the surveyed banks takes the form of hybrid products, which are loans combining fixed and floating rates, along with other options for the borrower. Based on the data collected for the survey, these loans account for only a tiny proportion of new lending in the French banking system. However, the banks in question should make a careful assessment of the associated risks, both for themselves and for the borrowers, and notably the risk in the event of a dispute with customers over the terms of these products.

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Keywords: residential loans to individuals, average loan amount, average maturity, loan-to-value ratio, debt service ratio, non-performing loans and provisions, cost of risk

JEL codes: G21, R21, R31

Preliminary comments

- This study is based on the information gathered through the annual survey by the Secretary General of the ACPR for 2014 as well as on the ACPR's monthly monitoring of new residential lending to individuals, which was set up in September 2011 and covers a sample of banks representing nearly 96% of outstanding housing loans to individuals at 31 December 2014.[1] The study also draws on additional external sources of information including the Banque de France, INSEE and the CGEDD (French sustainable development council).
- As in 2013, several banks sent in additional or corrected information for previous years along with their responses to the 2014 questionnaire, which has helped to make a number of indicators more representative and to correct misreported information. In particular, the study incorporates data from one institution which had not been taken into account since the overhaul of the survey, due to its late reply. As a result, some figures in the present study may differ from those published last year.

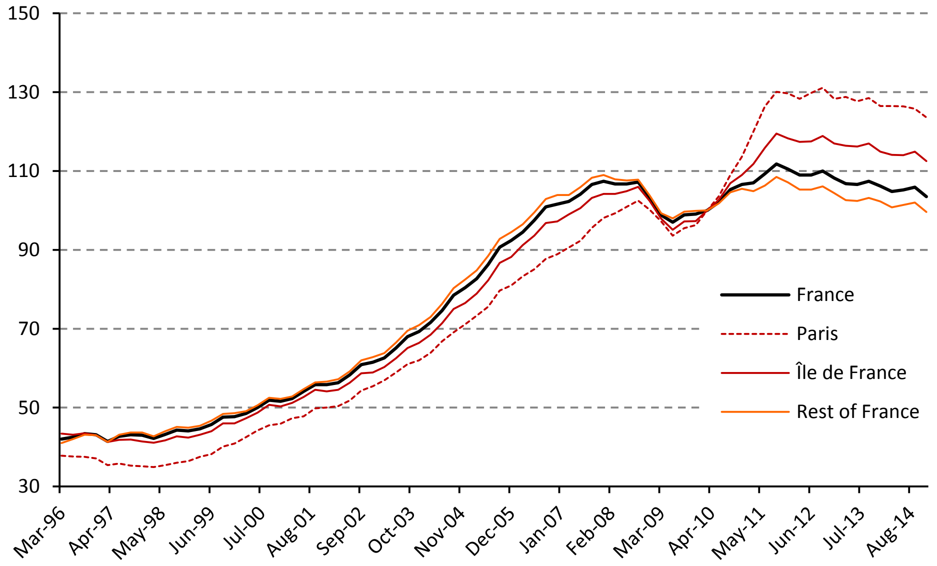
[1] BNP Paribas, BNP Paribas Personal Finance, Société Générale, Crédit du Nord, Caisses Régionales de Crédit Agricole, LCL, Caisses d'Epargne, Banques Populaires, Crédit Foncier de France, Crédit Mutuel, CIC, Crédit Immobilier de France, HSBC France and La Banque Postale.

1. Main features of the residential loan market

1.1. Continued downward drift in property prices and transaction volumes

The decline in property prices, which began in the second quarter of 2012, continued in 2014, with an overall fall of 2.4% over the year at national level (Chart 1). Once again, the fall was more marked in the rest of France (-2.5%) than in the Île de France region (-2%) and in Paris (-2.2%). Despite the decline, however, prices were still significantly higher than before the crisis in Paris (in December 2014 they were still around 20.7% above the peak reached in the third quarter of 2008), and, to a lesser extent, in the overall Île de France region (+7.3% compared with the second quarter of 2008).

Chart 1
Residential property prices for existing dwellings



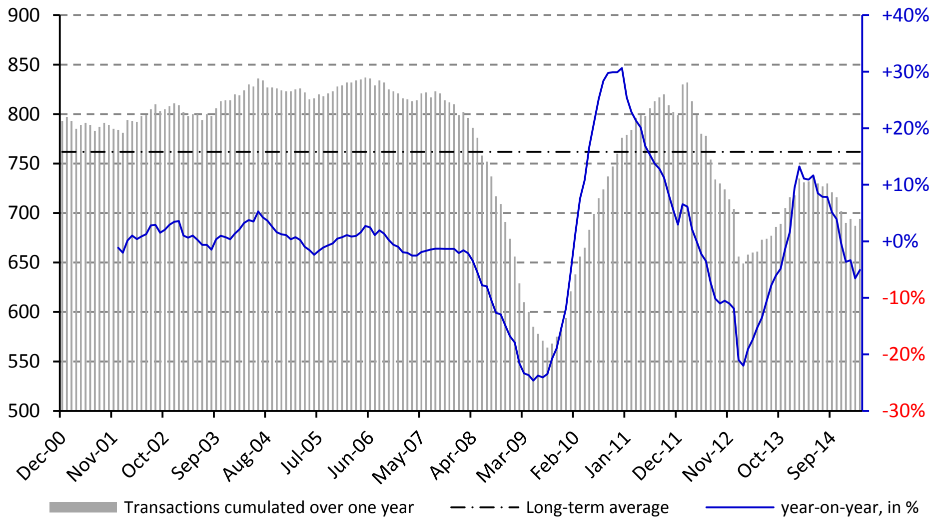
Source: INSEE

The first half of 2014 saw a marked recovery in transaction volumes; however the trend began to reverse in the second part of the year: in December, transactions in existing dwellings were down 3.5% year-on-year and were 9% below their long-term average;[2] the slide subsequently accelerated slightly in the first quarter of 2015, and at end-March 2015 transactions were down 4.8% on the year (Chart 2).

[2] The average annual number of transaction since 2000 is 762,844.

Chart 2

Transaction volumes on existing homes (thousands of units)



Source: CGEDD, based on figures from the French Public Finance Ministry (MEDOC) and notaries' databases

In contrast, the new dwellings market appears to be showing signs of recovery, and transactions have started to rise again since the fourth quarter of 2014.

1.2. Decline in new residential lending and moderate rise in outstanding loans

Note

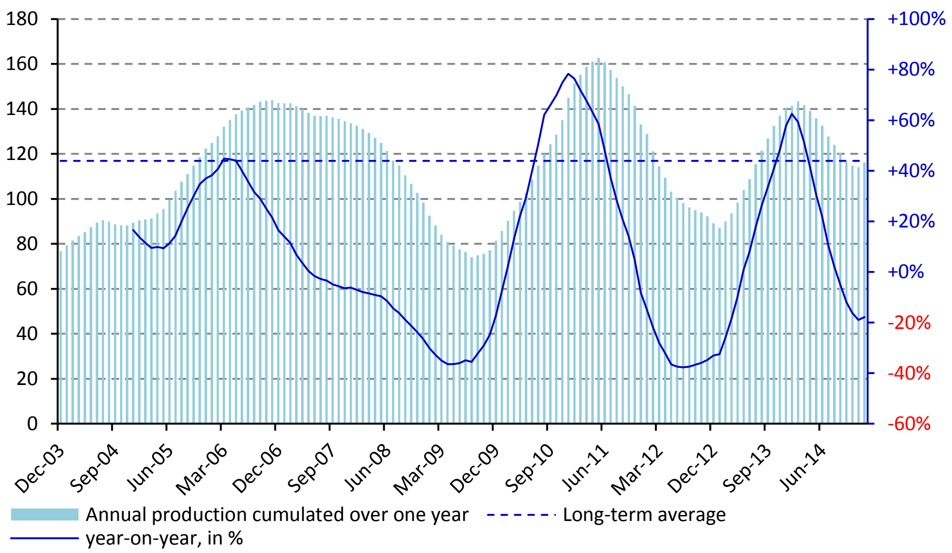
Loan transfers: transaction whereby a bank buys a borrower's loan from another bank. As loan transfers are followed by the provision of a new loan to the borrower (by the bank purchasing the original loan), they are included under gross new residential lending. They do not, however, affect the net balance of new residential lending[3] as the new loan is immediately offset by the repayment of the borrower's original loan to the other bank.

Renegotiation: transaction whereby the borrower obtains new terms on an original loan, notably a new rate of interest. Renegotiations do not result in the provision of a new loan and are therefore not included under new lending (gross or net).

2014 saw a slowdown in new residential lending, with the total flow declining by around 19% to EUR 114.1 billion from EUR 140.8 billion in 2013 (Chart 3). New lending has thus fallen slightly below its long-term average (EUR 115.6 billion since December 2003).

[3] Net lending for a given period is defined as new loan contracts minus repayments on existing loans (contractual or early repayments).

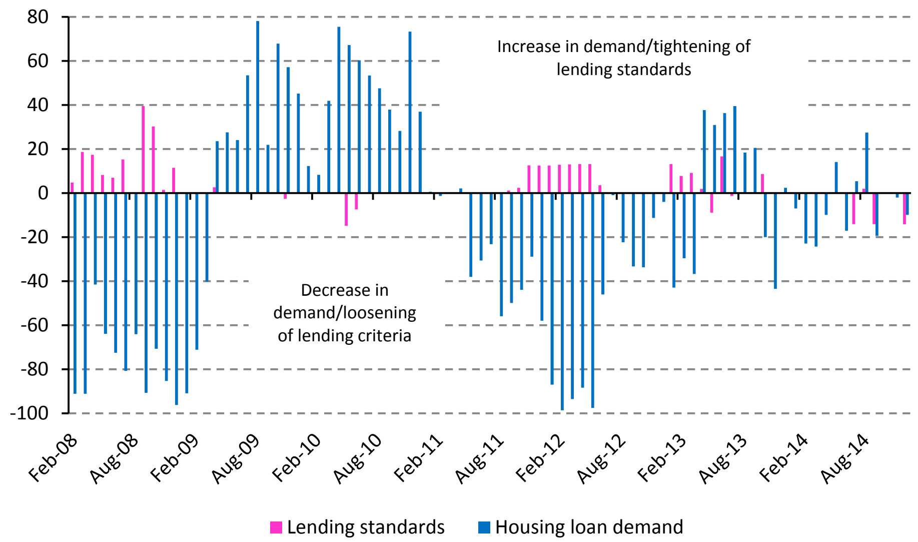
Chart 3
New residential loans (in EUR billions)



Source: Banque de France; New residential loans to individuals, seasonally adjusted flow, 12-month moving averages

This downturn in new lending reflects relatively weak credit demand, despite the slight easing in lending standards (Chart 4).

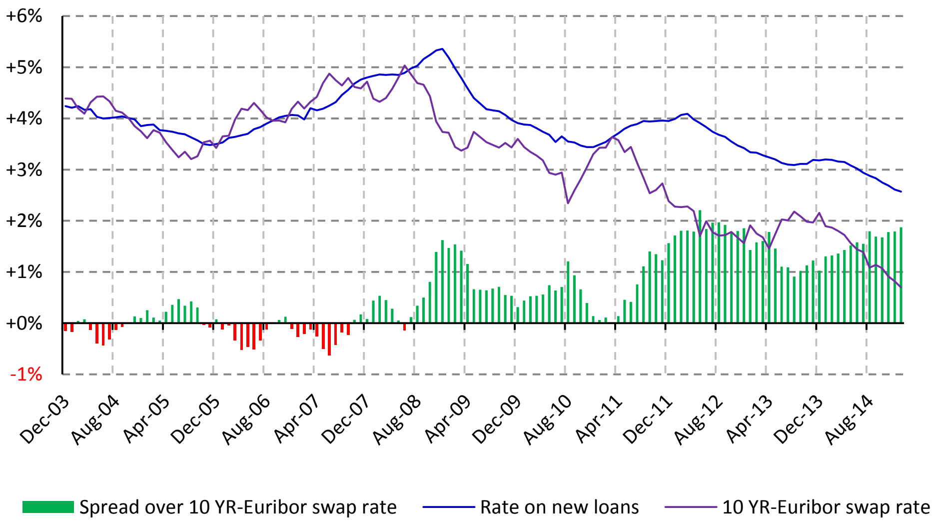
Chart 4
Lending standards and demand for residential loans



Source: Banque de France, monthly survey of bank lending in France

The weakness in demand is primarily down to lacklustre transaction volumes (see previous), which have continued to decline despite further cuts in interest rates. Interest rates have in fact fallen to record lows since mid-2013, although they are now declining at a slower pace than the 10 YR-Euribor swap rate (Chart 5).

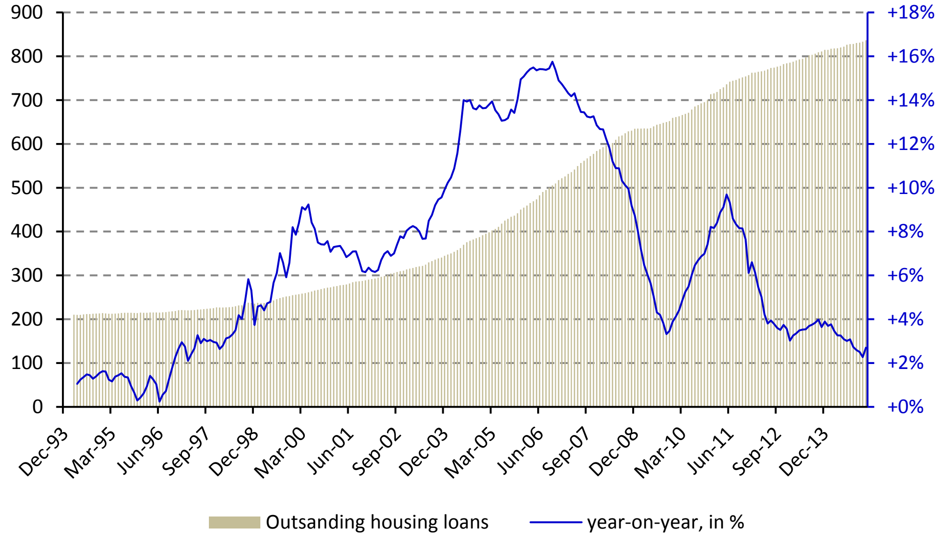
Chart 5
Interest rates on new residential loans



Source: Banque de France

Against this backdrop, the outstanding stock of residential loans rose at a much slower pace than in 2013 (+2.3% in 2014 compared with +3.9% in 2013), or than at the end of the financial crisis (+3.3% in October 2009; Chart 6).

Chart 6
Outstanding residential loans to individuals (in EUR billions)

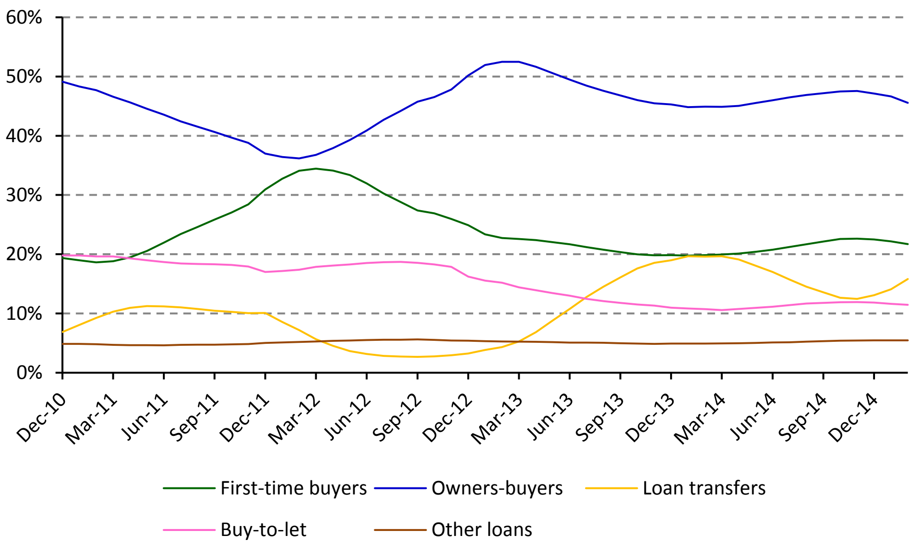


Source: Banque de France, Residential loans to French-resident individuals (including securitised loans)

1.3. Renewed rise in loan transfers

The overall structure of new lending was little changed between 2013 and 2014, with loans to existing homeowners for house purchases continuing to account for the majority of credit issuance (Chart 7).

Chart 7
New lending by market segment

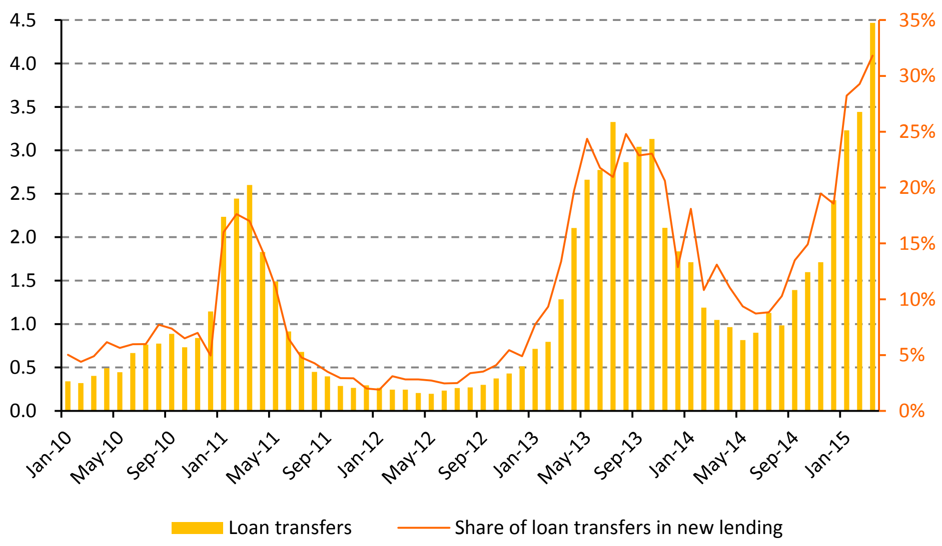


Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

Similarly, the geographical breakdown of new lending was unchanged in 2014, with the Île de France continuing to account for one quarter of all new loans. This breakdown has remained stable since the start of 2010.

One notable trend is the stark rebound in loan transfers since the fourth quarter of 2014, both in absolute and relative terms, which has been driven by the fall in interest rates (see Chart 5). The total amount of loan transfers hit an unprecedented EUR 4.1 billion in March 2015, accounting for 32% of new home lending at that date (Chart 8).

Chart 8
Loan transfers in EUR billions and as a % of new residential lending

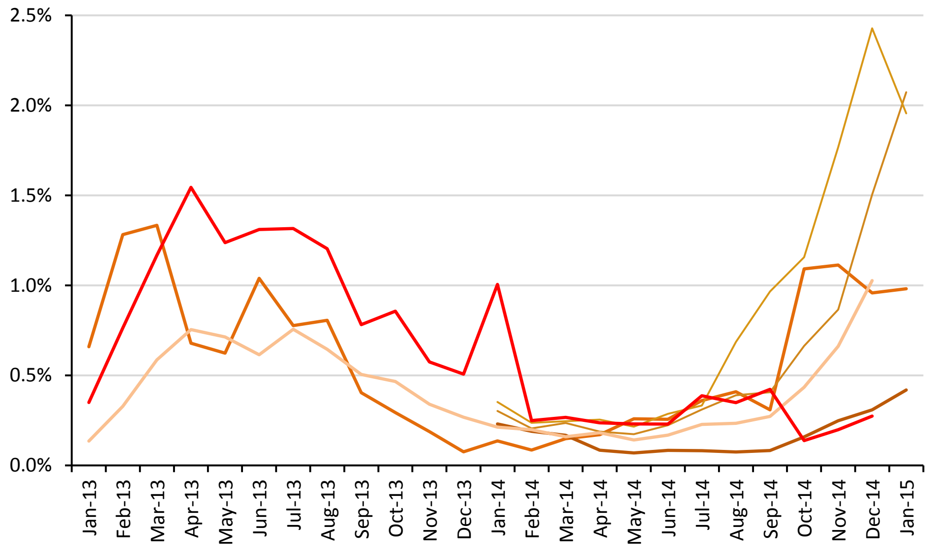


Source: ACPR, annual survey and monthly monitoring of new residential lending

Although all banks in the survey said they had seen a rebound in loan transfers (with the exception of a small number which are winding down their activity), two groups in particular appear to have adopted a more aggressive strategy than their peers: their respective shares of the loan transfer market are 4 and 5 percentage points higher than their shares of total new lending. Moreover, data obtained by the ACPR on two other banking groups show that the amount of loans they purchased from their competitors was more or less equal to the amount they were purchased from them by their competitors.

In parallel, loan renegotiations have risen sharply in recent months and, in the case of some banks, account for a growing share of outstanding residential loans. Trends for individual banks nonetheless vary (Chart 9).

Chart 9
Renegotiations of residential loans as a % of outstanding loans, for a sample of French banks



Source: ACPR, data obtained on request from a sample of French banks (each curve represents one bank)

The jump in loan transfers and in renegotiations nonetheless raises concerns over the medium- and long-term profitability of residential lending: although, in the near-term, these transactions have a positive impact on income (through the booking of early repayment penalties or renegotiation fees), they also drive down the average return on residential loans.

Lastly, although lending for buy-to-let investment picked up slightly in relative terms, the total amount of new lending in this segment contracted over the period, albeit to a lesser extent than overall new residential lending (-6.3% compared with -19% for all new residential loans). The flow of new bridge loans fell by 9.7% and remains relatively subdued, well below the levels seen in 2007 (Chart 10).

Chart 10

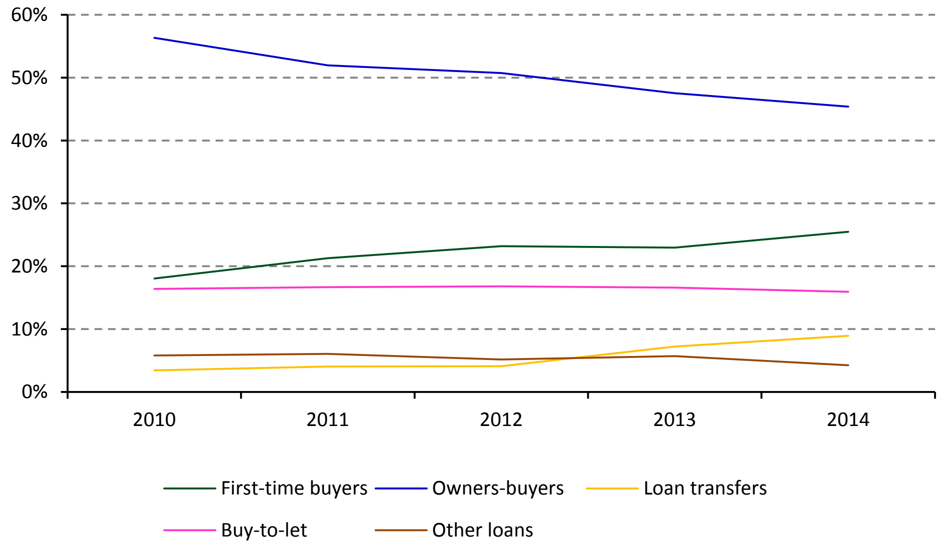
Share of buy-to-let investment and bridge loans in new residential lending

Source: ACPR, annual survey and monthly monitoring of new residential lending; 12-month moving averages

Against this backdrop, the breakdown of outstanding loans by market segment is continuing to shift gradually, with first-time buyers and loan transfers accounting for a growing share of new lending, and the share of loans to existing home-owners – which is still by far the largest segment – gradually shrinking. Loans for buy-to-let investment and other loans – which notably include loans for purchases of secondary residences – both remained relatively stable (Chart 11).

Chart 11

Breakdown of housing loan production

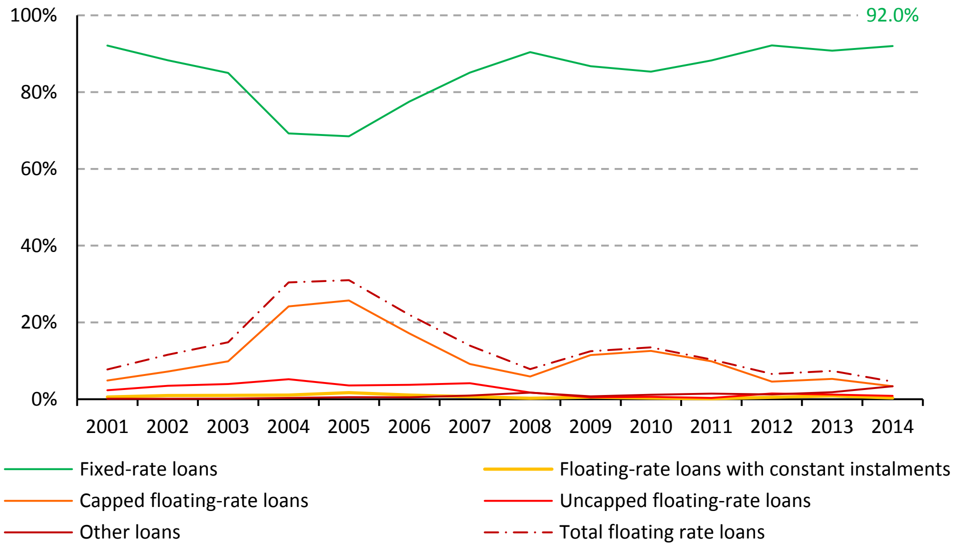


Source: ACPR, annual survey

1.4. Fixed rate loans still account for the majority of new lending

The proportion of new loans carrying a fixed interest rate interest has remained relatively stable over the past three years, and at end-2014 stood at 92%. Floating rate facilities account for only 4.6% of new lending, of which only 0.9% are uncapped floating rate products – which carry the highest risk for borrowers (Chart 12).

Chart 12
New lending by interest-rate type



Source: ACPR, annual survey

The "other loans" category, which accounts for only a marginal share of new lending, rose sharply between 2013 and 2014, almost doubling from 1.9% of new lending to 3.4%. This appears to be attributable primarily to two banks, and includes the following:

- in the case of one bank, loans on which repayments can be adjusted up or down by the borrower or even suspended for a fixed number of months;
- in the other case, hybrid loans, i.e. where the interest rate is fixed for a set initial period (of between 3 and 7 years, depending on the overall term of the loan), then switches to a floating rate, which is capped at either +/-1% or +/-2% relative to the initial fixed rate; the borrower can also choose to switch back to a fixed rate, subject to conditions.

In the case of floating rate loans, it is worth noting that the current ultra-low interest rate environment makes no major difference to the level of protection provided by the rate cap, as shown in Table 1.

Table 1
Impact of a rise in interest rates on capped floating rate loans

	Dec. 08	Mar. 15
Rate	5.36%	2.43%
Monthly instalment	1,020.01 €	789.75 €
Capped rate (+100 bps)	6.36%	3.43%
Monthly instalment	1,106.03 €	864.55 €
Change	+8.43%	+9.47%

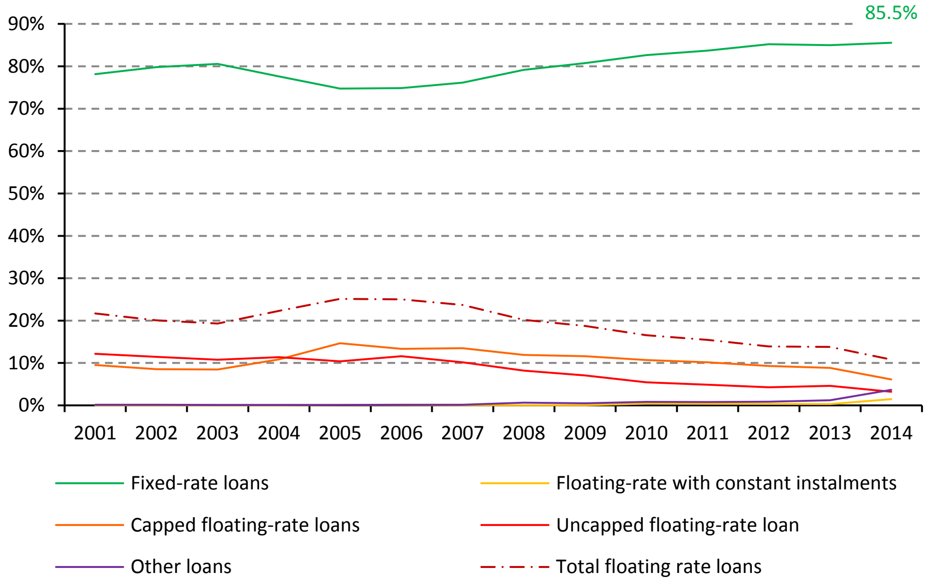
Source: Banque de France; ACPR calculations based on a 20-year loan of EUR 150,000

Thus, a borrower who took out a capped floating rate loan in December 2008[4] would see a 8.4% rise in monthly repayments if the interest rate hit the cap of +100 basis points (bps); whereas, a borrower who took out the same type of loan in March 2015 would see a 9.5% increase in repayments under the same conditions.

[4] Highest rate observed since January 2003 (see Chart 5).

The proportion of outstanding residential loans carrying a fixed rate of interest has also remained more or less stable over the past three years, and stood at 85.5% in 2014. The share of floating rate loans, meanwhile, has declined steadily from the peak reached in 2005 (25.5%) and now stands at just 10.9%, of which only 3.2% are uncapped floating rate products (Chart 13).

Chart 13
Outstanding loans by interest rate type



Source: ACPR, annual survey

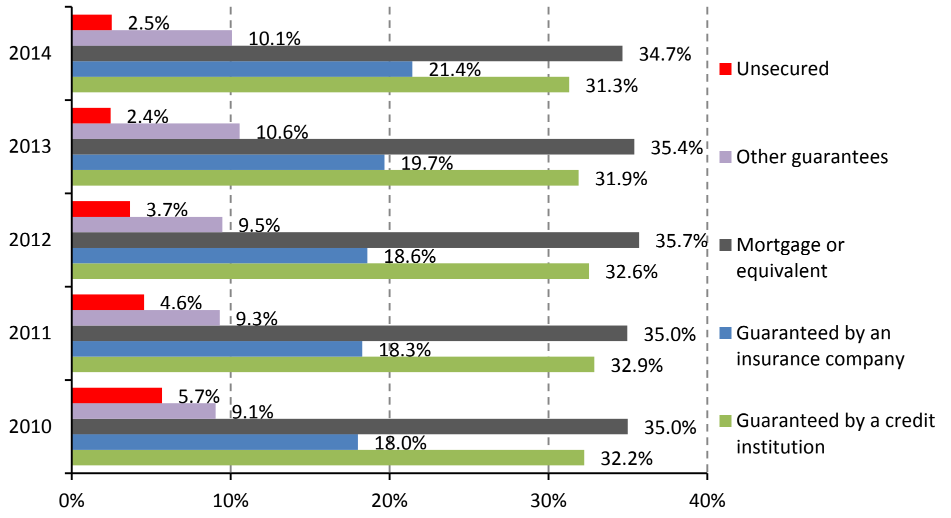
As previously, the share of "other loans" remains modest, but nonetheless tripled between 2013 and 2014, rising from 1.2% of total outstanding credit to 3.6%.

1.5. Nearly all outstanding loans are secured

As in 2013, nearly all new residential loans originated in 2014 were secured (Chart 14).[5]

[5] The reporting of secured loans by surveyed banks could be improved: for example, adding together the total amount of loans reported by banks as being secured by Crédit Logement gives a much lower figure than the total amount of secured credit actually reported by Crédit Logement (EUR 214 billion versus EUR 254.3 billion); similarly, only one bank in the survey had reported a loan guaranteed from SGFGAS (public guarantee scheme aiming at low income borrowers) even though nearly all banks surveyed provide loans with this type of security.

Chart 14
Outstanding loans by type of security



Source: ACPR, annual survey

As the chart shows, real guarantees (i.e. mortgage or lender's lien) are the most popular category, accounting for just over a third of total outstanding loans, although this share has fallen back by 1 percentage point from its peak in 2012.

The second-largest category is loans with a credit institution guarantee – these have consistently accounted for just over 30% of outstanding loan stock, although their share has declined fairly steadily since 2011 (-1.6 percentage point or pt; the majority of loans in this category are guaranteed by Crédit Logement, Sociétés de Caution Mutuelle Immobiliere (SOCAMI), Banques Populaires or Cautionnement Mutuel de l'Habitat (CMH, Crédit Mutuel's credit guarantee business).

Although they only make up the third-largest category, at 21.4% of outstanding loans, insurance company guarantees have risen significantly since 2010 (+3.4 pts), with a marked acceleration in 2014. The vast majority of loans in this segment are guaranteed by Compagnie Européenne de Cautionnement et de Garantie (CEGC – part of BPCE) and Caisse d'Assurances Mutuelles du Crédit Agricole (CAMCA). It is worth noting, however, the recent entry into this segment of Parnasse Garanties, a subsidiary set up in 2014 by Casden (part of BPCE; 80% share) and Mutuelle Générale de l'Education Nationale (20% share) to reinsure their residential lending.

Among other guarantees, which include a variety of products such as collateral, personal guarantees etc., one of the most notable providers is Société de Gestion des Financements et de la Garantie de l'Accession Sociale à la Propriété (SGFGAS), which helps banks to distribute State-guaranteed or – subsidised loans such as interest-free loans, interest-free eco loans and help-to-buy schemes (the *Prêt à l'accession sociale* or PAS)[6].

The vast majority of borrowers have some form of home-loan insurance which provides coverage in the event of death and work disability. However, unemployment insurance remains rare, despite the fact that rising joblessness is one of the biggest risks to bank residential loan books (Chart 15). It should nonetheless be stressed that France's system of unemployment insurance means borrowers who lose their job receive benefits equivalent to all or part of their lost income for up to two years.

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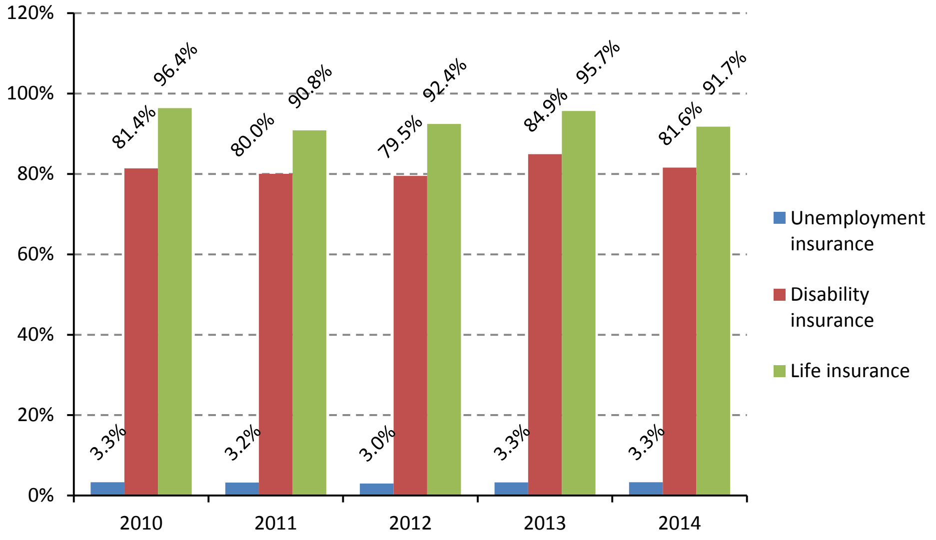
[6] See https://www2.sgfgas.fr/web/guest/presentation-sgfgas1 for a description of SGFGAS.

Chart 15

Proportion of borrowers covered by an insurance policy



Source: ACPR, annual survey

2. Borrower risk profile

The vast majority of new and outstanding residential loans are still fixed rate or capped floating rate products, meaning that borrowers are largely shielded from the risk of an interest rate rise and, conversely, can take advantage of rate cuts to renegotiate their loan or get better terms from a competing bank, thus improving their solvency. Hence the importance of monitoring lending standards is key.

With regard to lending standards, French banks generally base their decision to approve a loan on an assessment of the borrower's solvency and on his/her ability to meet loan repayments as they fall due. As such, they tend to focus mainly on income stability and loan affordability and, contrary to practices in other markets, particularly Anglo-Saxon countries, the value of the property is most often a secondary consideration.

2.1. Rise in average loan amount

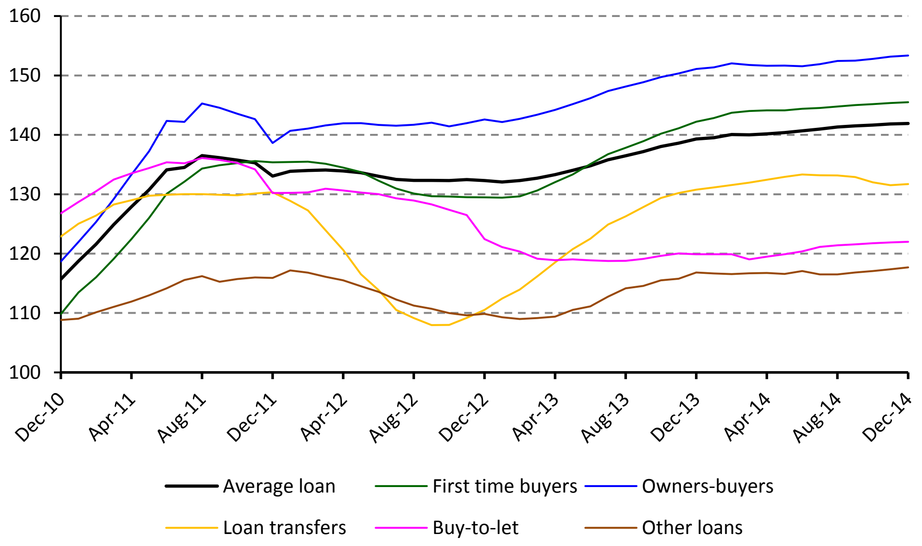
The average loan amount continued to rise in 2014, hitting EUR 145,232 (+1.9% versus 2013). Since 2011, therefore, loan sizes also appear to have decoupled from trends in residential property prices (Chart 16).

Chart 16
Average loan amount (in EUR millions) and property prices

Source: ACPR, annual survey and monthly monitoring of new residential lending; INSEE (Index of prices of second-hand dwellings, Metropolitan France)

Average loan sizes have increased for nearly all types of transaction, with the exception of loan transfers where the average amount has declined slightly since mid-2014 (Chart 17).

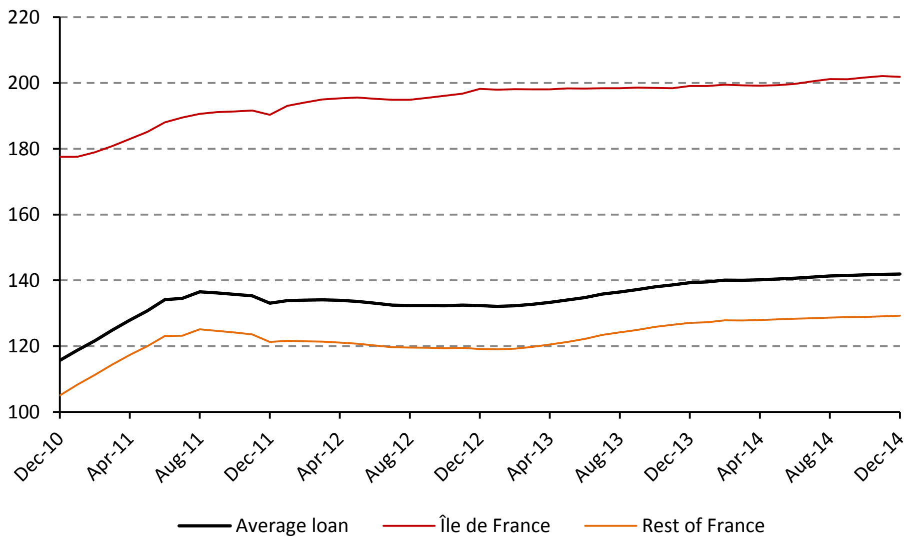
Chart 17
Average loan amount by market segment(in EUR thousands)



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

In geographical terms, the average loan amount has risen both in the Île de France region and in the rest of France, although at a slightly slower pace in the former than in the latter (+1.4% compared with +1.8%; see Chart 18).

Chart 18
Average loan amount by region



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

2.2. Initial and residual maturities have declined

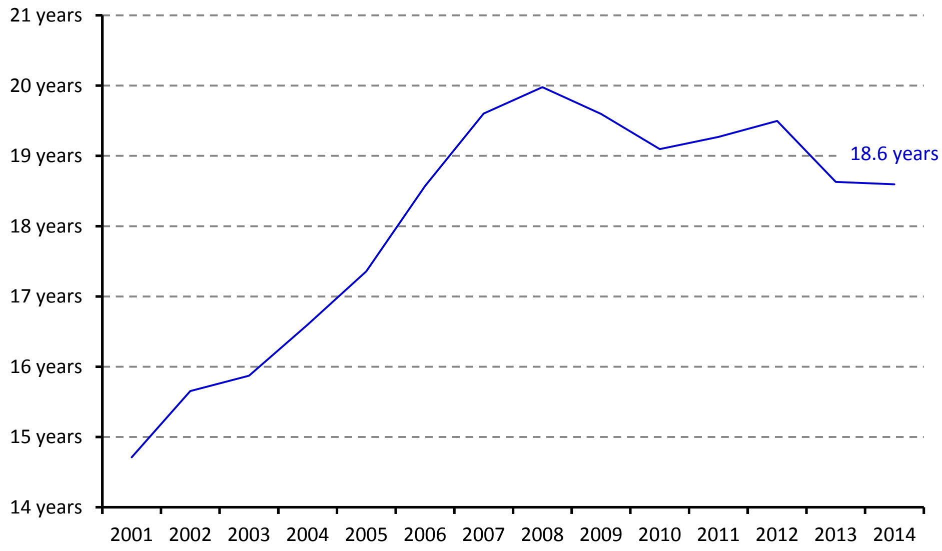
Note

Initial maturity: for a given loan vintage, this is the average of all initial maturities as set up in the lending contract, weighted by the outstanding loan balance.

Residual maturity: remaining expected life of the loan until its expiry date, as set up in the lending contract.

The initial maturity on residential loans, excluding bridge loans, continued to decline in 2014, falling to 18.6 years (Chart 19).

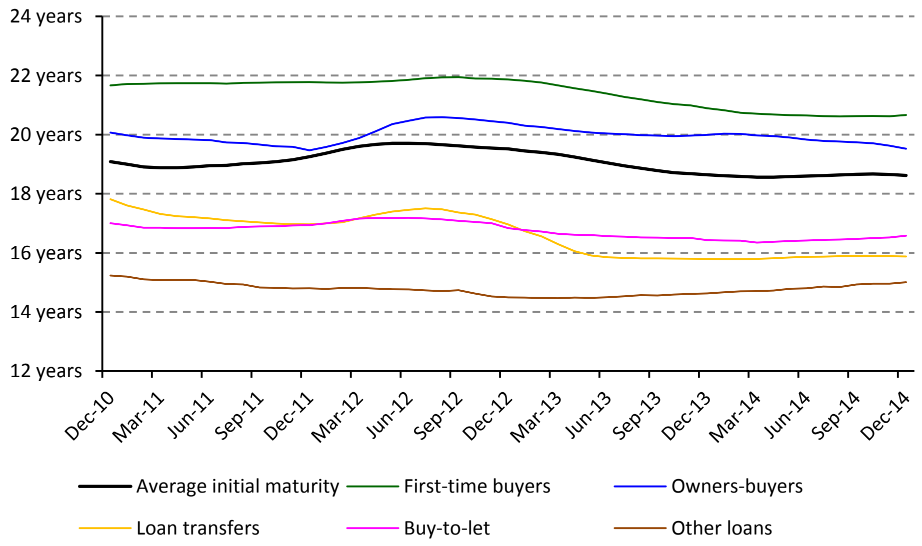
Chart 19
Initial loan maturity (excl. bridge loans)



Source: ACPR, annual survey and monthly monitoring of new residential lending

This overall decline masks contrasting trends according to loan type: in the case of loans to owners-buyers and first-time buyers, initial maturities fell by 0.4 year and 0.3 year respectively; for loan transfers and buy-to-let investment maturities were more or less unchanged (0.01 year respectively), while for other loans they increased by 0.4 year, continuing the trend observed since the start of 2013 (Chart 20).

Chart 20
Initial loan maturities (excl. bridge loans) by market segment

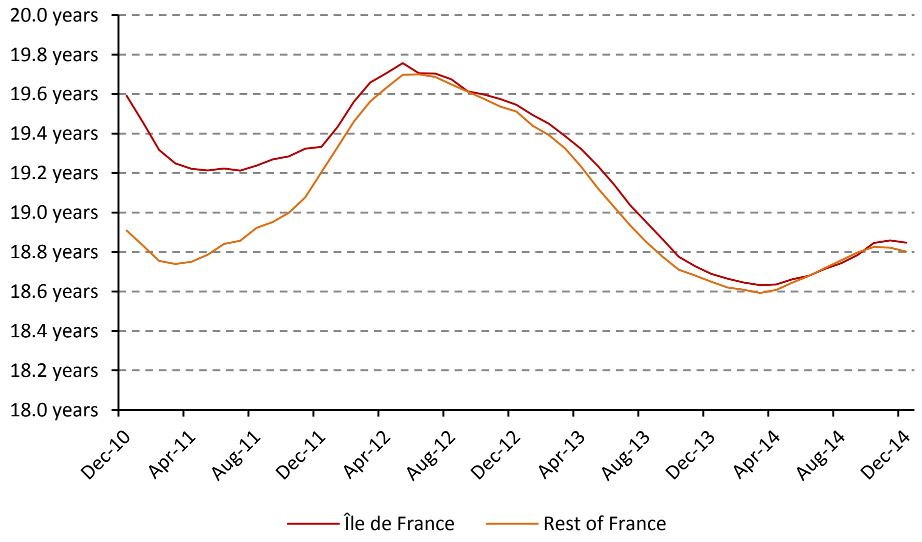


Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

Seven banks said they did not offer loans with maturities of over 25 years, or only did so to a very limited extent. At the other banks, the longest-term loans (i.e. with an initial maturity of over 25 years) were mainly advanced to young customers (aged under 40-45); and in the case of two banks, they were essentially to first-time buyers with a small down payment, or who qualified for the help-to-buy scheme or for an interest-free loan; a third bank reported that the majority of its very long-term lending was to buy-to-let investors.

Lastly, average initial maturities on loans, excluding bridge loans, and trends in those maturities were almost identical in Île de France and in the rest of France (Chart 21).

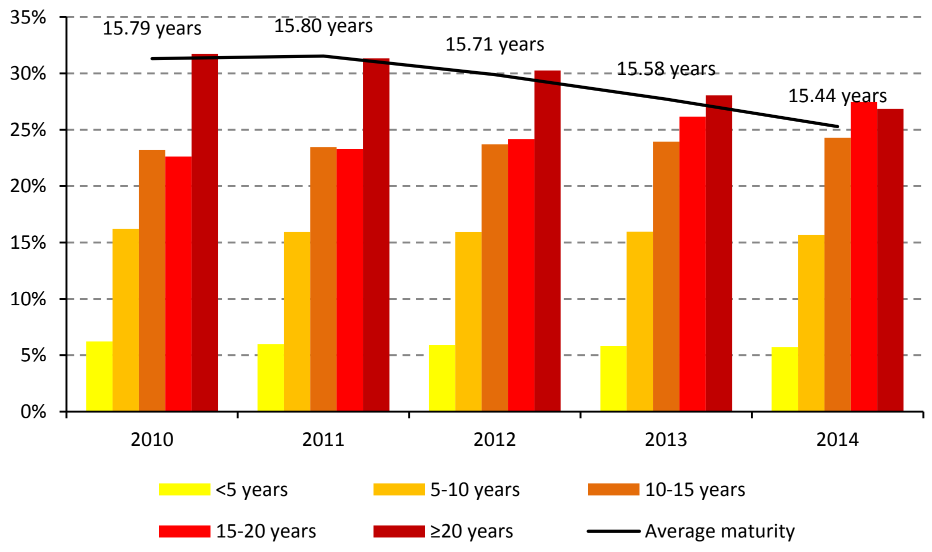
Chart 21
Initial loan maturities (excl. bridge loans) by region



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

The average residual maturity on outstanding residential loans continued the downward trend observed since 2011 (-0.36 year to 15.44 years), driven by the gradual fall in the outstanding stock of facilities with a residual maturity of over 20 years (from 31.3% of total stock to 26.8% over the past 4 years), and by the rise in those with a residual maturity of 15-20 years (+4.18 pts over the same period; see Chart 22). Another contributing factor could be the increase in loan transfers and loan renegotiations, as some borrowers took advantage of the cut in interest rates to shorten the remaining term of their loans.

Chart 22
Outstanding residential loans by residual maturity



Source: ACPR, annual survey

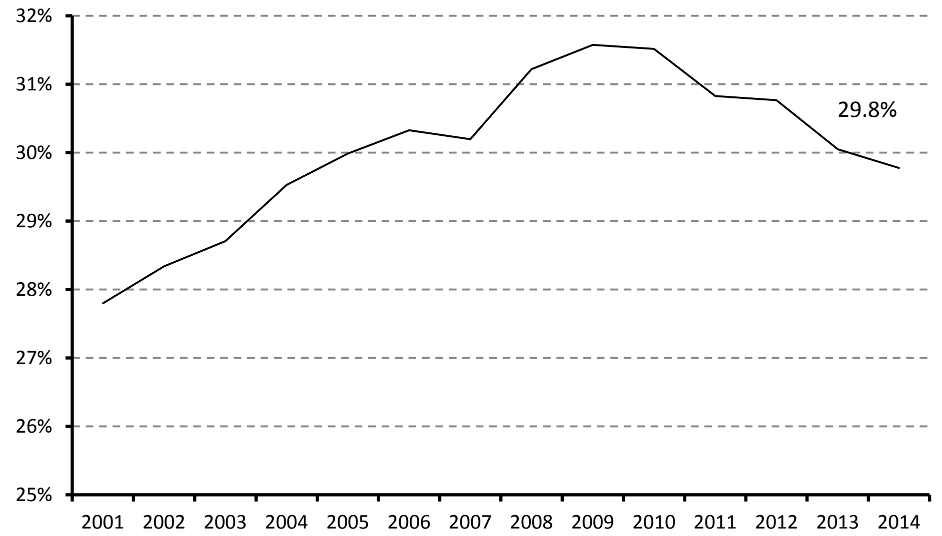
2.3. Decline in the average debt service ratio and in the share of borrowers with high debt service ratios

Note

The debt service ratio is calculated by dividing all of the borrower's regular outgoings (including repayments of all loans) by the his/her gross income.

Since peaking at 31.6% in 2009, the average debt service ratio at origination for borrowing households has fallen fairly steadily and in 2014 reached 29.8%, which is below its 2005 level (30%; see Chart 23).

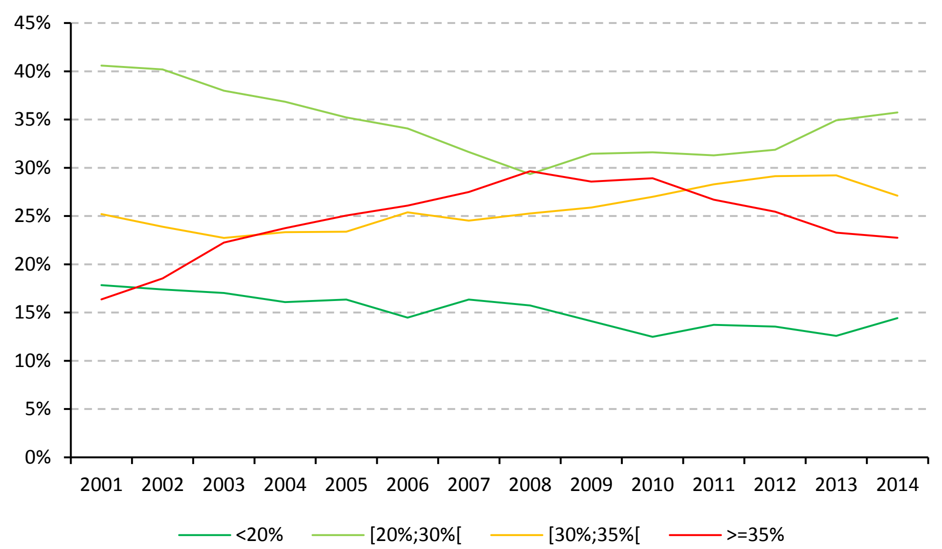
Chart 23
Average debt service ratio at origination



Source: ACPR, annual survey and monthly monitoring of new residential lending

This notably reflects the gradual decline in the proportion of new lending to the most heavily indebted borrowers, which fell to 22.7% in 2014 after peaking at 29.6% in 2007 (Chart 24).

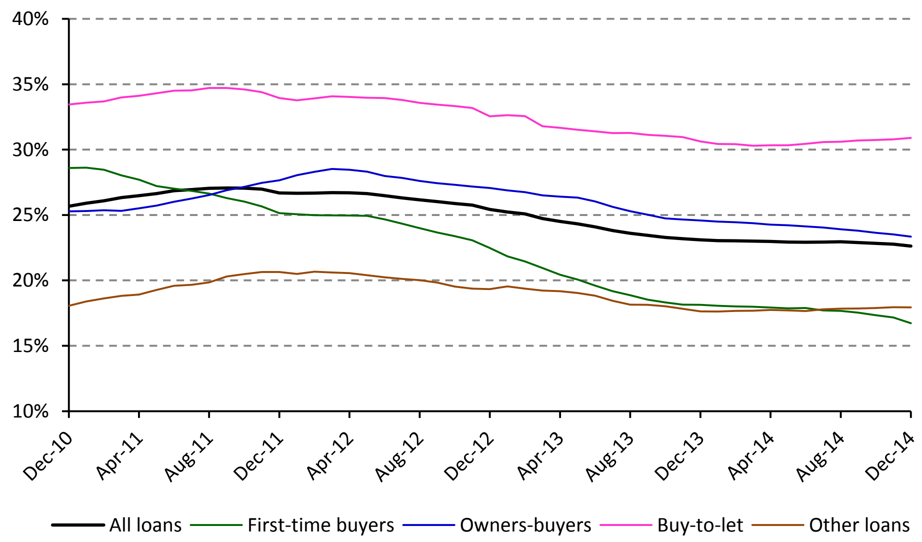
Chart 24
Share of new lending by debt service ratio



Source: ACPR, annual survey and monthly monitoring of new residential lending

Debt service ratios of over 35% are mainly found on loans for buy-to-let investment and have declined sharply among first-time buyers since 2010 (Chart 25).

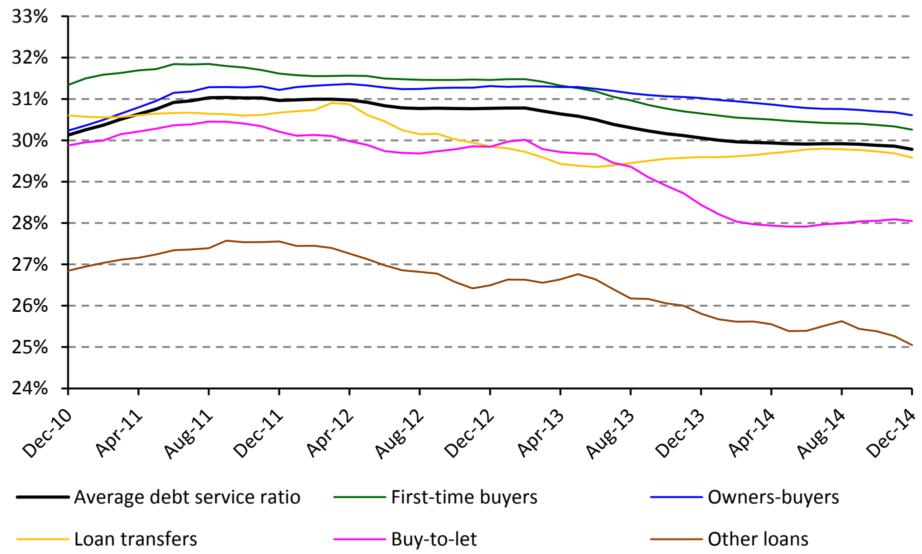
Chart 25
Share of loans with debt service ratio of over 35%, by market segment



Source: ACPR, monthly monitoring of new residential lending; 12-month averages

Although the average debt service ratio for all types of loan has only declined to a limited extent, this masks more marked falls in the case of buy-to-let investment and other loans (Chart 26).

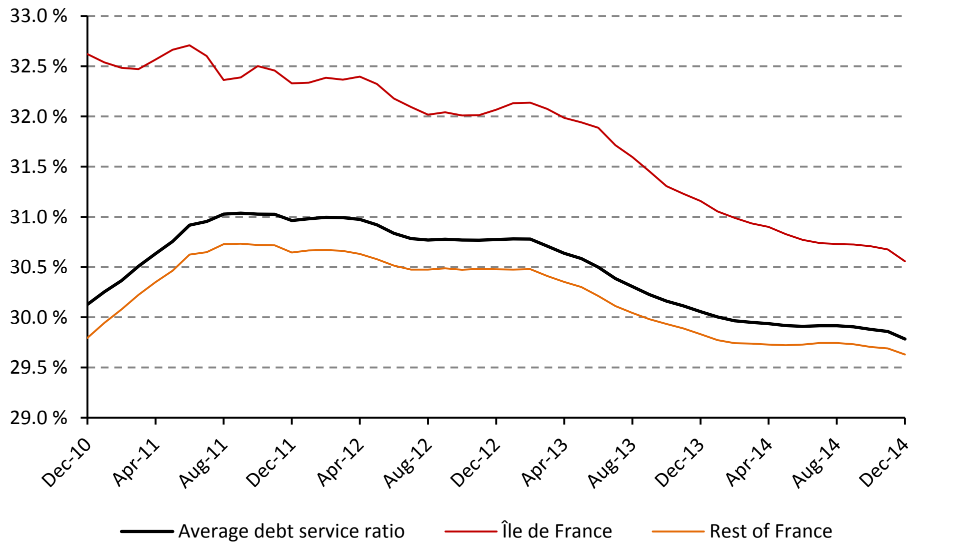
Chart 26
Debt service ratio by market segment



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

Lastly, the average debt service ratio fell at a similar rate in both Île de France and the rest of France, although a significant gap remains between the two regions, with the former showing substantially higher levels (Chart 27).

Chart 27
Average debt service ratio by region



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

2.4. Rise in average initial borrower income

Note

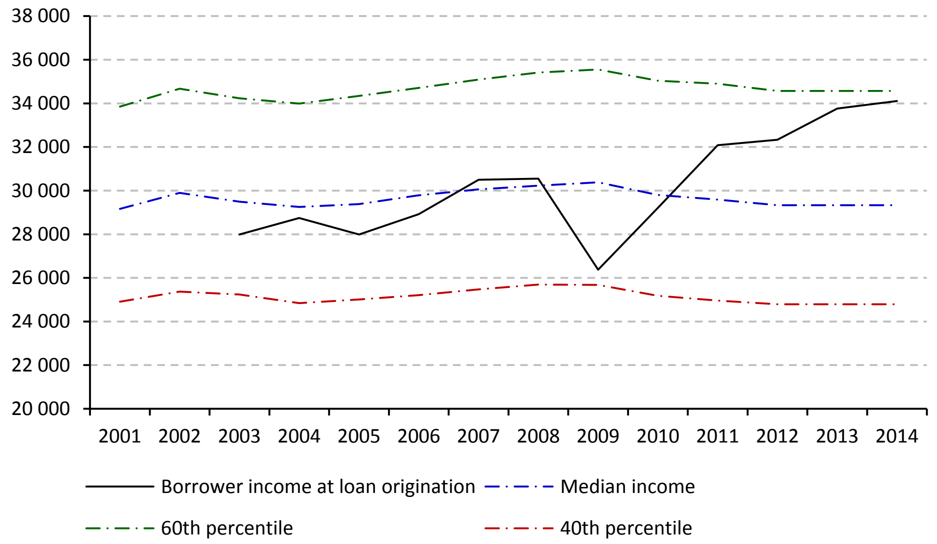
The average borrower income at origination is estimated using the following method (proxy method):

- First, an estimate is made of the total repayment due in a given year on an average-sized loan with an average initial maturity and an average rate of interest; in 2014, based on a loan of EUR 145,232 with an initial maturity of 18.6 years and a fixed interest rate of 2.95%, the total repayment due over the year is EUR 10,158;
- Second, using this repayment amount and the average initial debt service ratio, it is then possible to calculate the average initial borrower income (i.e. the average income of the borrower at loan origination); in 2014, based on an average debt service ratio of 29.8%, the average initial borrower income was EUR 34,105.

Over the long term, and with the exception of the sharp decline observed in 2009 when the average loan amount fell markedly (Chart 16), average borrower income at origination has increased steadily, rising from EUR 27,991 in 2003[7] to EUR 34,570 in 2014, i.e. a rise of 23.5%. Since 2011, it has been substantially higher than the median income, and in 2014 it came close to the 60th percentile (Chart 28). This shows that banks have gradually shifted their lending more towards borrowers with higher levels of income, and potentially with higher levels of assets.

[7] First year for which average interest rates on new lending are available.

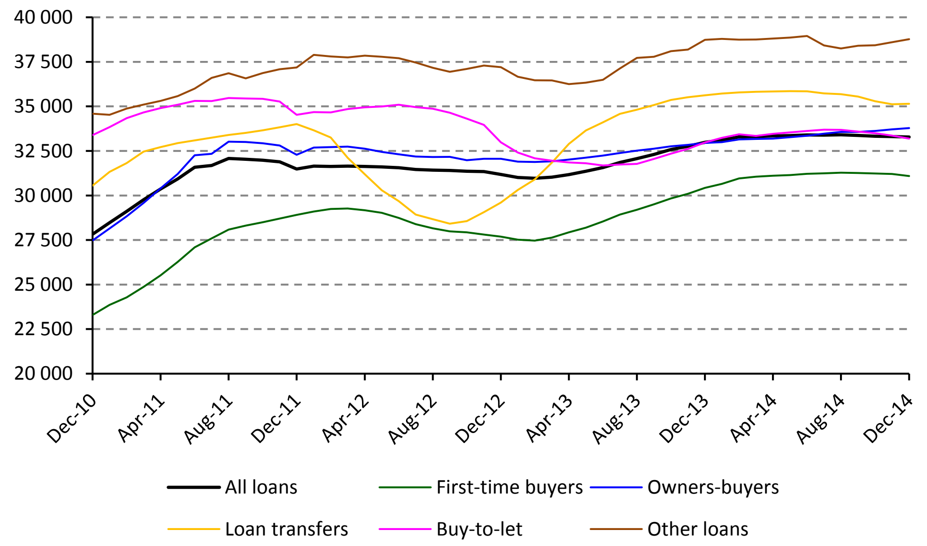
Chart 28
Average borrower income at origination, in euros



Source: Banque de France; INSEE; ACPR, annual survey and monthly monitoring of new residential lending

A closer analysis reveals that first-time buyers have seen the sharpest rise in initial income levels (+34.3% since end-2010) although, as a group, they still earn some 6% less than the average. At the top end of the scale, borrowers in the "other loans" and "loan transfers" category are by far the highest earners, although in the latter case average income levels have fluctuated markedly over the period under review (Chart 29).

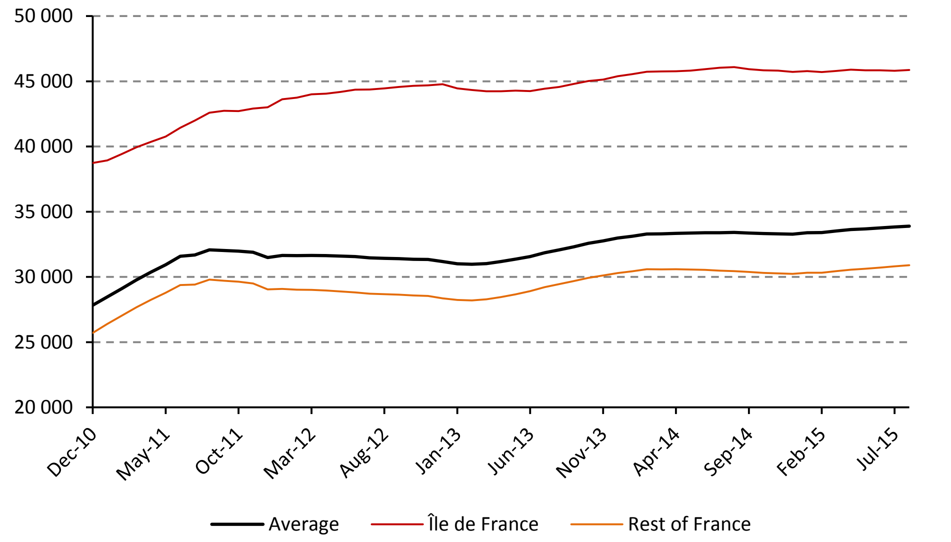
Chart 29
Average borrower income at origination, by market segment (in euros)



Source: Banque de France; INSEE; ACPR, annual survey and monthly monitoring of new residential lending

Lastly, while income levels have grown at a similar pace in both Île de France and the rest of France since end-2010 (+18% and +17.7% respectively), borrowers in the former region tend to earn well above the average (+37.4%; see Chart 30).

Chart 30
Average borrower income at origination, by region (in euro)



Source: Banque de France; INSEE; ACPR, annual survey and monthly monitoring of new residential lending

2.5. The loan-to-income ratio at origination has stabilised at a high level

Note

The loan-to-income ratio or LTI at origination is the ratio of the average initial loan amount to the average estimated borrower income at that date.

The LTI thus shows how many years of income a borrower would need to repay a residential loan.

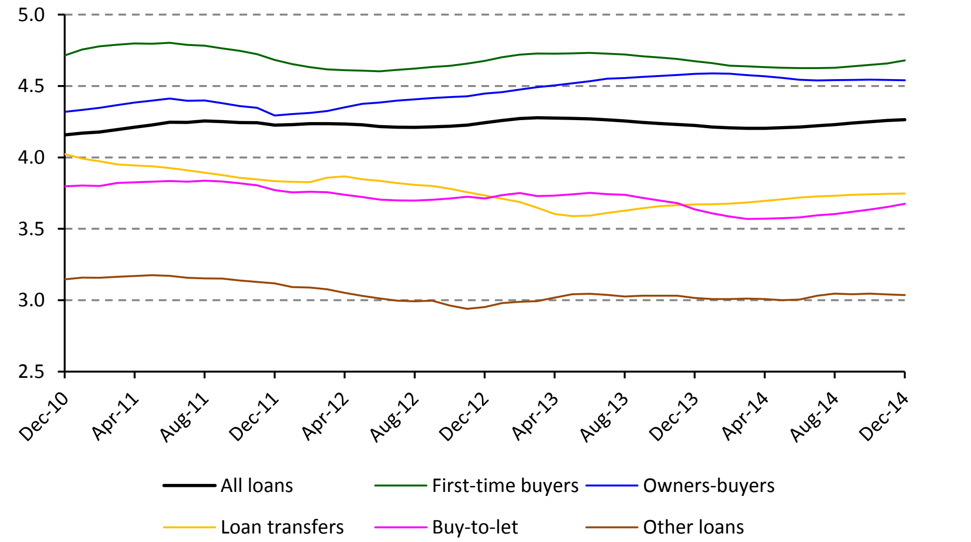
After rising rapidly between 2003 and 2010, the average LTI at origination stabilised from 2011 onwards. Since then, loans have averaged just over 4 times annual borrower income (4 years and 3 months in 2014; see Chart 31).

Chart 31
Average LTI at origination

Source: ACPR, annual survey and monthly monitoring of new residential lending

Average initial LTIs have risen markedly for all categories of borrower. In the case of owners-buyers, however, the average LTI has increased sharply since the end of 2010, whereas, for all other types of borrower, it has stabilised or even fallen over the same period (Chart 32).

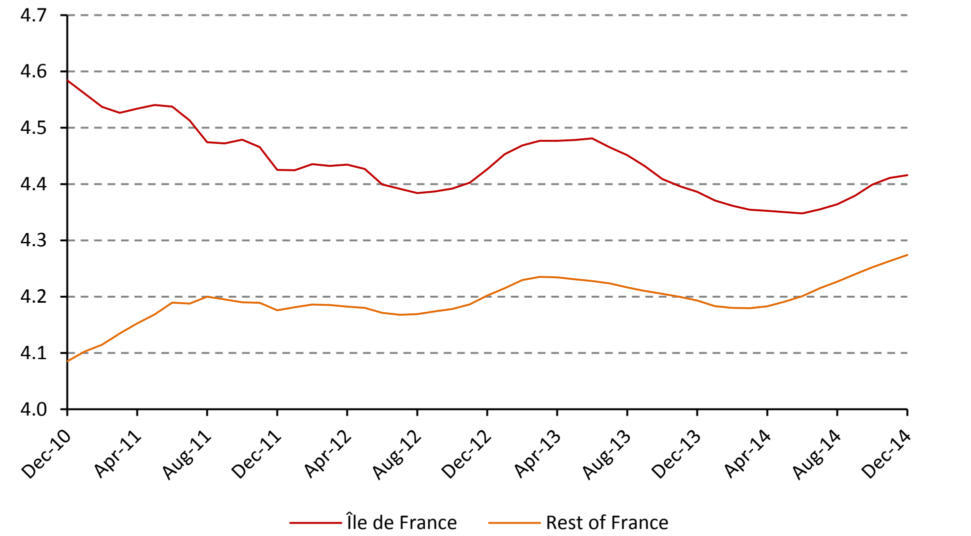
Chart 32
Average LTI at origination, by market segment



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

Lastly, although the average LTI is generally much higher for borrowers in Île de France than in the rest of France, the gap between the two is gradually narrowing; indeed, since 2010, LTIs in both areas have followed contrasting trends, with Île de France initially registering a downturn and the rest of France an upturn. Nonetheless, since mid-2014, trends in both areas appear to have become more correlated, thanks to an upturn in LTIs in Île de France (Chart 33).

Chart 33
Average LTI at origination, by region



Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

2.6. Decrease in average LTV at origination; stabilisation of average LTV on outstanding loan stock

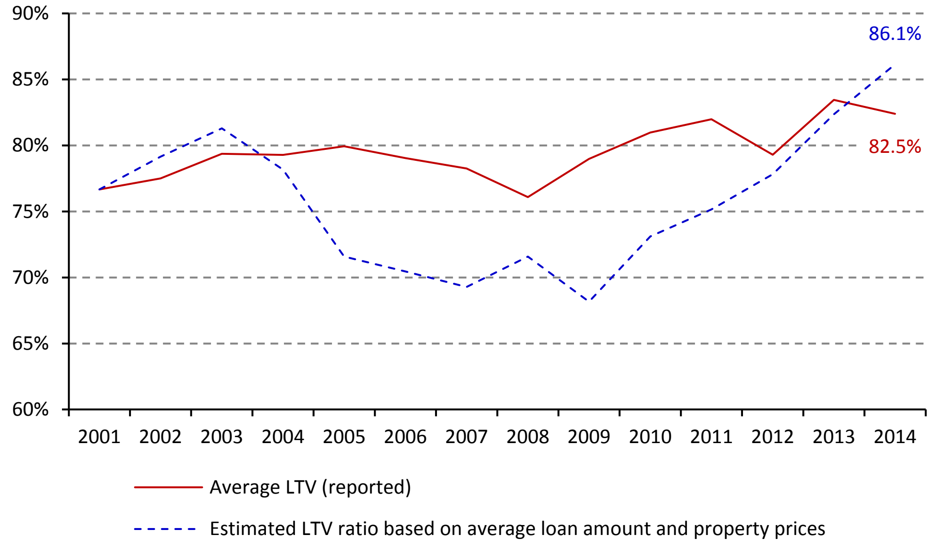
Note

The loan to value (LTV) ratio at origination is the ratio between the amount of the main residential loan and the price of the purchased property (excluding stamp duty and legal fees). It can also be defined as the difference between 1 and the borrower's down payment rate. Banks in the survey report the average LTV per transaction weighted by the amount of new residential loan approvals over the period.

During the life of the loan, the LTV is the ratio between the outstanding principal of the loan and the market value of the financed property. Although this information has been included in the ACPR annual survey since its revision in 2012, at present, only a small minority of respondents are in a position to provide it. As a result, the ACPR has developed a method for estimating the average LTV on the entire outstanding stock of residential loans (see Methodology 1).

After peaking in 2013, the average LTV at origination dropped back slightly from 83.4% to 82.5% in 2014, falling below its theoretical level for the first time since 2003 (Chart 34).[8]

Chart 34
Average LTV at origination

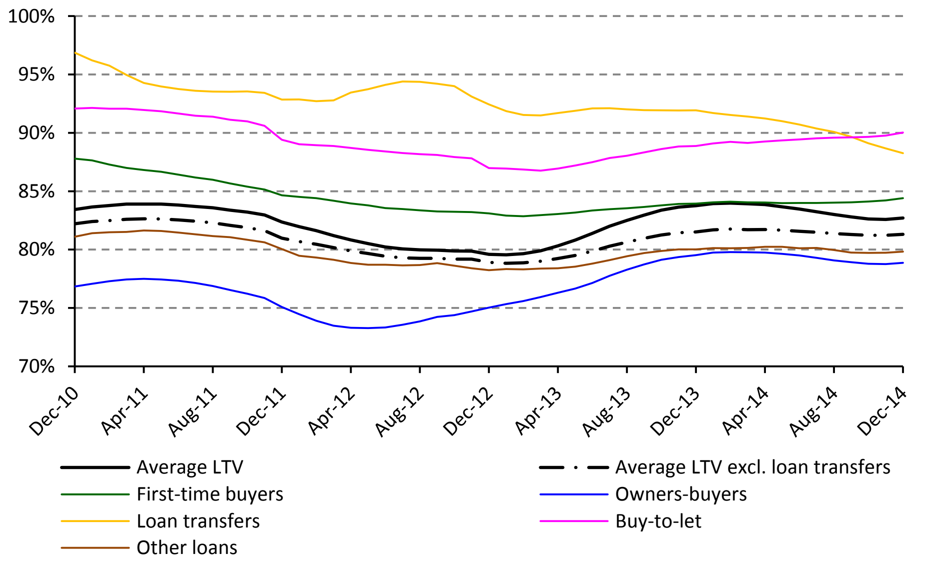


Source: ACPR, annual survey and monthly monitoring of new residential lending; INSEE

As in 2013, the decline in the average LTV in 2014 can be ascribed both to trends in the main segment of the market (i.e. loans to owners-buyers), and to a sharp drop in the LTV on loan transfers (-3.2 pts to 88.7%), which is now lower than that for buy-to-let investments (see Chart 35). This fall in the average LTV on loan transfers is attributable almost exclusively to one bank in the survey, which reported a drop from 100.3% to 75.7% in the space of one year (-24.6 pts); in contrast, the vast majority of surveyed banks continued to report very high LTVs for this segment - often close to 100% - indicating that loan management systems have not yet been adjusted to take into account the value of the property when the new loan was originated rather than the outstanding principal on the loan at the time of transfer.

[8] The average LTV at origination for 2001 (LTV_{2001}) is updated each year, using the average loan amount (L) and the property price index (I): $\forall n > 2001,\ LTV_n = LTV_{2001} \times (L_n/L_{2001})/(I_n/I_{2001})$. The difference between the two curves is interpreted as the result of a structural effect (change in the proportion of loans with a higher/lower LTV than average) and changes in lending standards, although the respective contributions of the two variables cannot be identified at this stage.

Chart 35
Average LTV at origination, by market segment

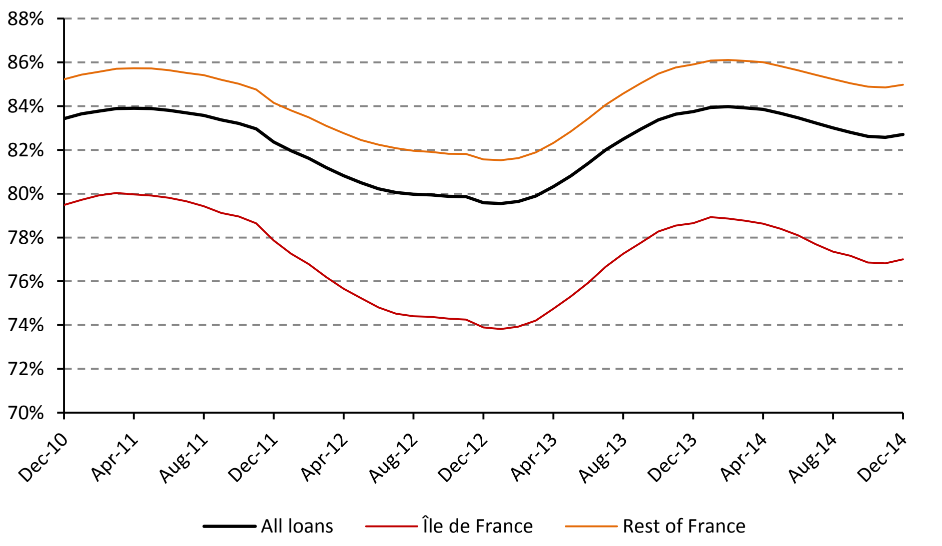


Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

Excluding loan transfers, the average LTV was virtually unchanged between 2013 and 2014, edging down just 0.2 pt from 81.5 % to 81.3%.

In terms of geographical breakdown, the average LTV at origination fell both in Île de France and the rest of France, though it remained much lower in the former region due to the sharp rebound observed in property prices since the financial crisis (Chart 36).

Chart 36
Average LTV at origination, by region



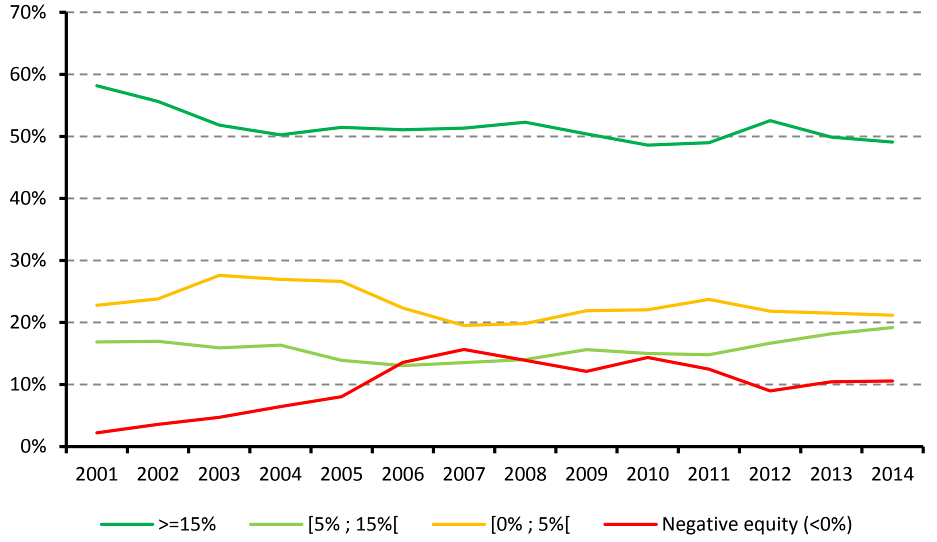
Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

A breakdown of new lending by down payment ratio shows that the share of transactions with a large down payment (i.e. ≥ 15%) has remained fairly constant at around 50% since 2003 (Chart 37). In the case of loans exceeding the value of the property (negative equity loans)[9] however, trends have been more varied: after rising sharply from 2003 to 2007 and rebounding in 2010, loan approvals in this

[9] Loans where the down payment is negative, i.e. where the bank finances the price of the property plus the associated transaction fees and taxes, and/or the cost of the credit guarantee.

category began to recover gradually in 2012, and have stabilised at just over 10% of new lending. Lastly, since 2011, transactions with a down payment of between 5% and 15% have risen markedly (+4.4 pts to 19.2% in 2014).

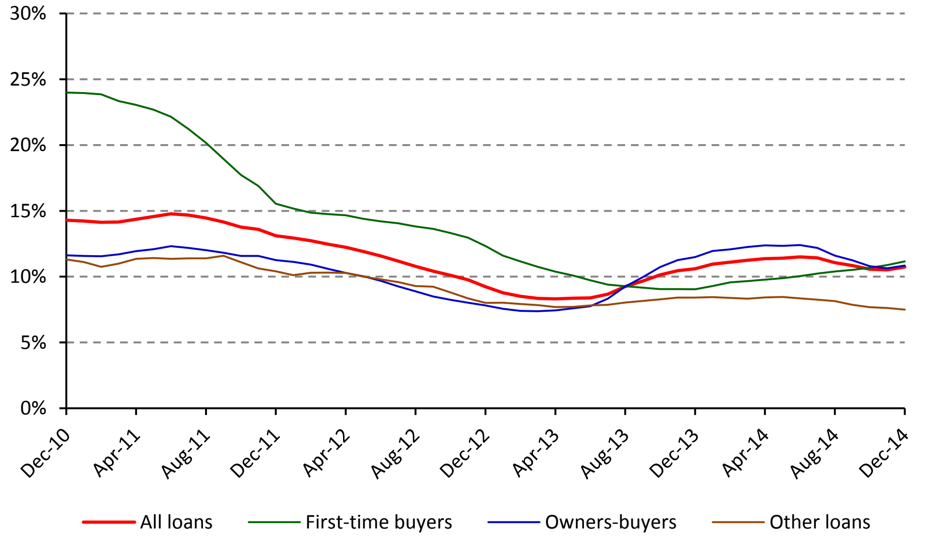
Chart 37
Breakdown of new lending by size of down payment



Source: ACPR, annual survey and monthly monitoring of new residential lending

A more detailed analysis reveals that the share of negative equity loans granted to first-time buyers has fallen sharply since end-2010 (Chart 38). Owners-buyers are now the largest borrowers in this category, although they only account for a marginally higher share than first-time buyers.

Chart 38
Share of negative equity loans by loan purpose



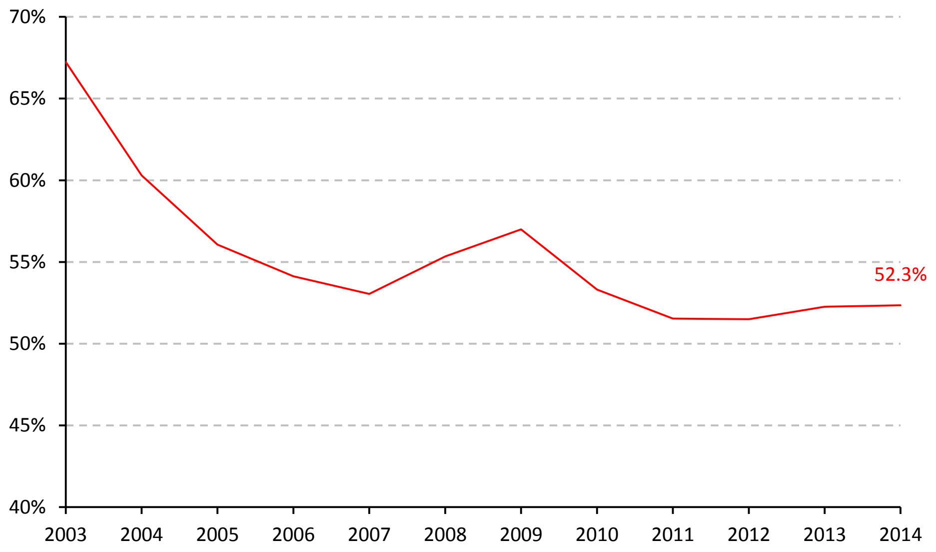
Source: ACPR, monthly monitoring of new residential lending; 12-month moving averages

At the same time, despite the continuing decline in residential property prices, the LTV on the outstanding stock of residential loans – as estimated by the ACPR[10] – remained unchanged in 2014 at 52.3% (Chart 39). All other things being equal, and based on the average LTV, property prices would have to fall by a little over 47%

[10] See Methodology 1.

for the value of financed properties to be less than the remaining principal of outstanding loans.

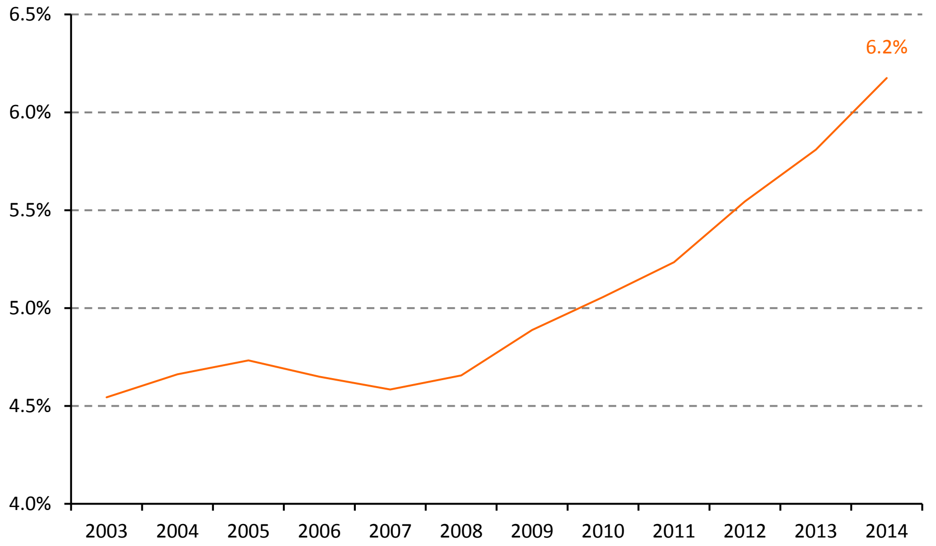
Chart 39
Estimate of the LTV on outstanding residential loans



Source: Banque de France, INSEE and ACPR annual survey ACPR calculations

Leaving out loan transfers and loan renegotiations, the falls in loan rates (Chart 5) and in the average initial loan maturity (Chart 19) have led to a mechanical increase in the rate of amortisation since 2007 (Chart 40), helping to offset the impact of the decline in property prices in 2014.

Chart 40
Ratio of amortisation to outstanding residential loan stock



Source: Banque de France, INSEE and ACPR annual survey; ACPR calculations

Methodology 1:
Calculating the LTV on the outstanding loan stock

An estimate was made of the LTV of outstanding residential loans based on annual loan vintages since 2003,[11] and the average characteristics of the loans at

[11] First available year in the figures published by the Banque de France.

origination (interest rate, maturity, LTV), taken from the ACPR annual survey and the residential property price index (whole of France):

- based on the amount of loan vintage k ($CRD_{0,k}$), as well as the average interest rate (t_k) and the average initial maturity (d_k) of loans of this vintage, the annual repayment amount is calculated (A_k), assuming that all the loans are issued at the beginning of the year; therefore, the outstanding principal of loan vintage *k* for year *n*, is[12]:

$$CRD_{n,k} = CRD_{0,k} - \sum_{i=0}^{n-1} \left(A_k - CRD_{i,k} \times t_k\right)$$

- based on the amount of loan vintage *k* and the corresponding average LTV at origination ($LTV_{0,k}$), the total value of financed property at origination ($V_{0,k}$): $V_{0,k} = CRD_{o,k}/LTV_{0,k}$ is estimated, and these properties are subsequently revalued each year based on the price index for existing residential property (*I*, assuming, as a preliminary estimate, that all properties follow the price index for France as a whole); thus, the value of properties for year *n* is:

$$V_{n,k} = V_{0,k} \times I_n/I_0$$

- the LTV of loan vintage *k* for year *n* is calculated by comparing the outstanding principal of that vintage for year *n* against the revalued property for the same year: $LTV_{n,k} = CRD_{n,k}/V_{n,k}$; the LTV of outstanding residential loans for year *n* is estimated by adding together all loan vintages:

$$LTV_n = \sum_{k=1}^{n} CRD_{n,k} \Big/ \sum_{k=1}^{n} V_{n,k}$$

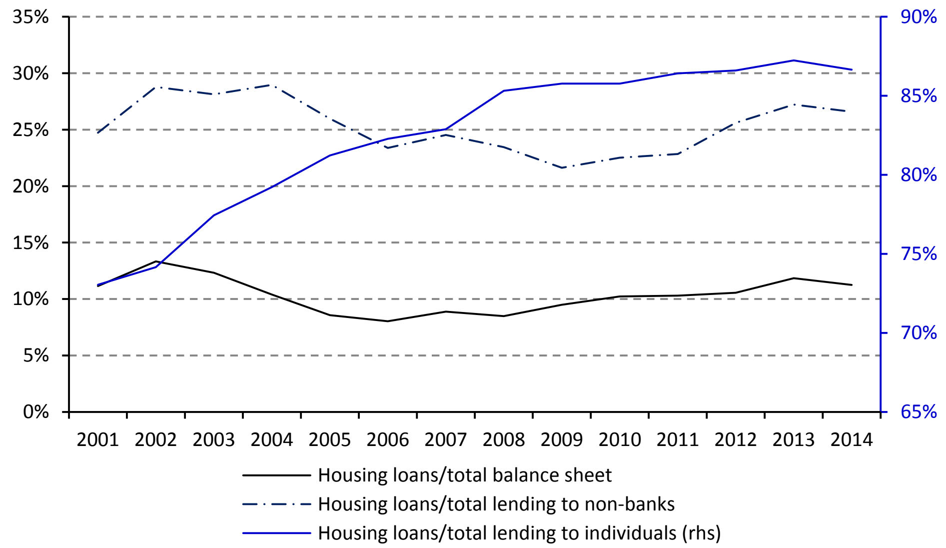
[12] The model only takes account of contractual repayments; early repayments are not included.

3. Banks' risk exposure on residential lending

3.1. Slight rise in the share of residential loans to individuals

As a share of the total consolidated balance sheet of the surveyed banks, residential lending to individuals in France has increased fairly steadily since 2008, rising from 8.5% to 11.3%. Nonetheless, this remains below the peak reached in 2002, when residential lending accounted for 13.3% of the total consolidated bank balance sheet (Chart 41). Similarly, as a share of total loans to non-banks, residential lending began to increase again as of 2009, rising to 26.6% in 2014, although this is still below the peak of 29% observed in 2004. Lastly, residential loans to individuals account for a growing share of overall lending to individuals – 86.7% in 2014 compared with 73% in 2001. In all cases, however, 2014 marked a slight change in trend, with all three indicators declining slightly relative to 2013.

Chart 41
Share of residential loans to individuals



Source: ACPR, annual survey and banks' accounting and prudential data

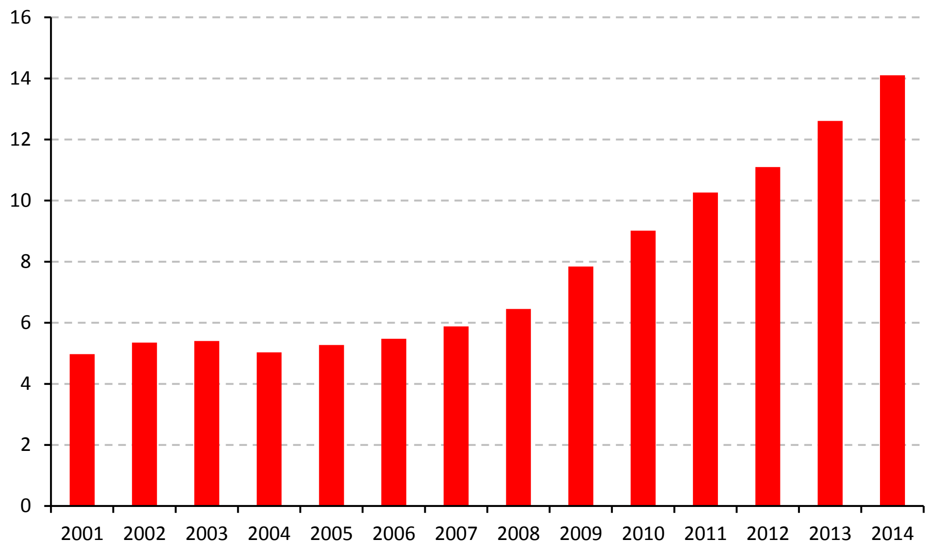
The trends observed over the period reflect a faster pace of growth in outstanding residential loans than in the total balance sheet and in overall loans to non-banks.

3.2. Non-performing loans and provisioning

3.2.1. Continued rise in gross outstanding non-performing loans (NPL) and in the gross NPL rate

The gross outstanding stock of non-performing loans rose to a new high of EUR 14.1 billion in 2014, up 12% versus 2013 (Chart 42).

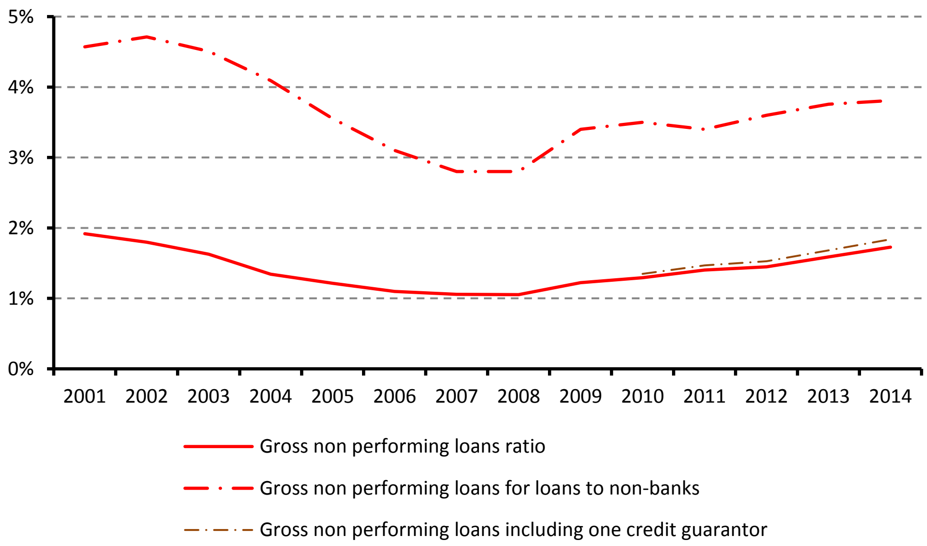
Chart 42
Gross outstanding non-performing loans in EUR billions



Source: ACPR, annual survey

As a result, the gross NPL rate for residential loans to individuals continued to trend upwards in 2014, rising to 1.73%, which is only slightly below the 2001 level of 1.92%. Nonetheless, the NPL rate for residential loans is still well below the overall rate for all lending to non-banks by French resident credit institutions (Chart 43).[13]

Chart 43
Gross NPL rate



Source: ACPR, annual survey; banks' accounting data; annual report

If the non-performing loans for the only one loan guarantor for which data are currently available are taken into account, the gross NPL rate for residential

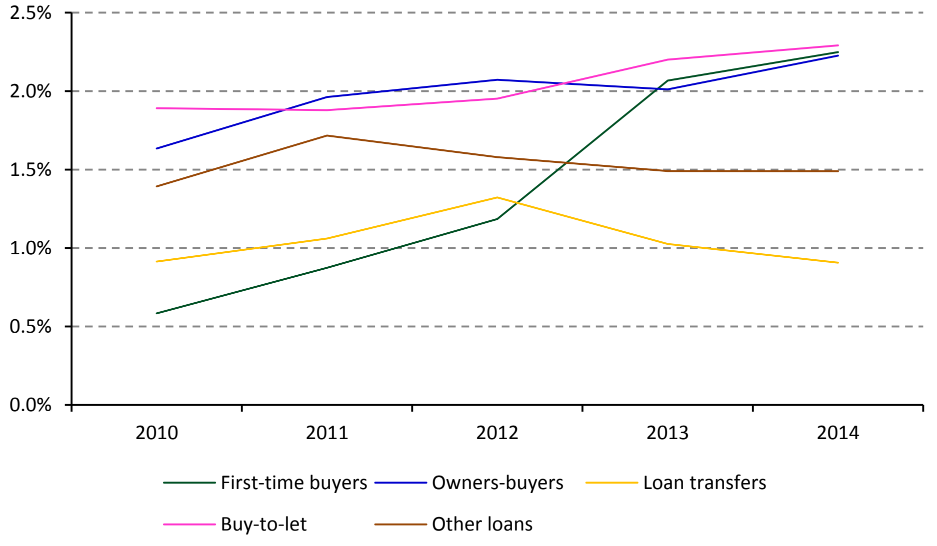
[13] Loans to non-banks (to resident and non-resident customers) include:

- commercial loans, export credits, cash loans, investment credits, housing loans and other credit, factoring, securities received under repurchase agreements and current account overdrafts.
- loans issued to non-financial corporations, own-account workers, individuals, insurance corporations and pension funds, non-profit institutions serving households (NPISH), central governments, local government and social security funds,
- loans to financial customers (mutual funds, etc.).

lending comes out at 1.84% in 2014, up from 1.35% in 2010. Indeed, this guarantee society has seen a rise in defaults comparable to the rest of the market. Furthermore, for this guarantor, the ratio between non-performing loans and commitments accounted for just 0.78% of total guaranteed credit in 2014 (excluding guarantee agreements not yet implemented), compared with 0.44% in 2010.[14]

Based on the survey responses – which only reflect a segment of the overall market[15] – the categories "other loans" and "loan transfers" stand out as having the lowest gross NPL rate, with defaults declining respectively since 2011 and 2012 (Chart 44). The rates for loans to buy-to-let investors and existing owners-buyers are more or less in line and have seen fairly similar rises over the period. In the case of first-time buyers, however, the gross NPL rate has increased more than fourfold since 2010.

Chart 44
Gross NPL rate, by market segment



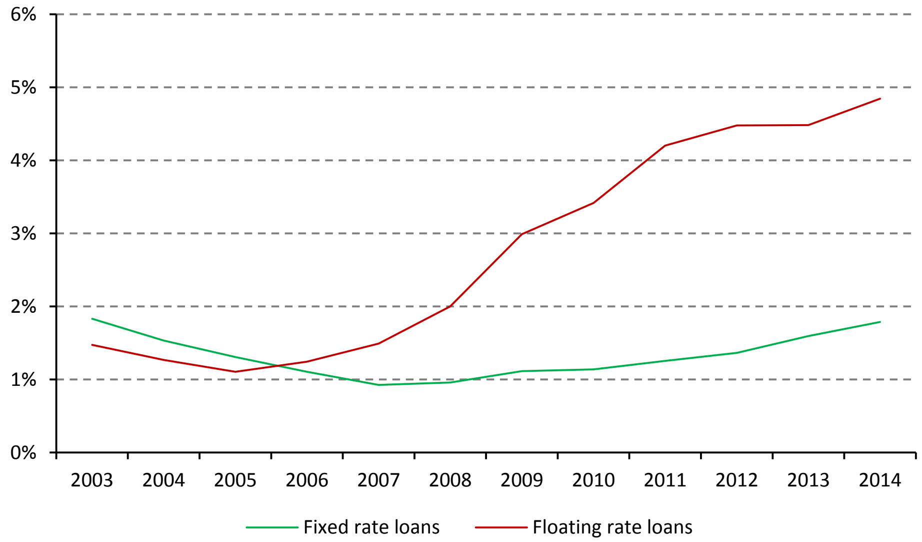
Source: ACPR, annual survey

Lastly, loan defaults continued to rise in 2014 on both fixed and floating rate facilities, although the gross NPL rate was markedly higher for the latter type of loan (Chart 45). This tends to confirm that it generally targets more financially vulnerable borrowers who opt for floating rate loans, as these products usually offer lower rates than fixed rate loans of the same maturity.

14 Source: annual reports.

15 Certain institutions are still unable to provide a breakdown of non-performing loans and provisions by loan purpose or interest rate type (see Representivity section in the Excel spreadsheet accompanying this survey). As a result, the average reported NPL rates and NPL coverage ratios can differ from the rates obtained when overall non-performing loans and provisions are broken down by loan purpose and interest rate type.

Chart 45
Gross NPL rate by interest rate type

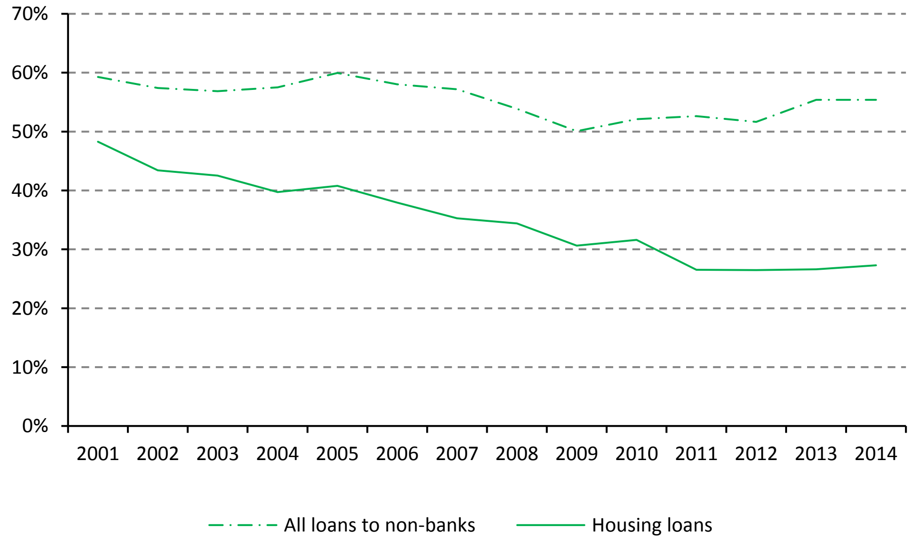


Source: ACPR, annual survey

3.2.2. Slight improvement in the NPL coverage ratio since 2011

After falling fairly steadily since 2001, the average NPL coverage ratio for residential loans has risen slightly since 2011, and in 2014 stood at 27.3%. Although this is well below the average NPL coverage ratio for overall lending to non-banks by French banks to resident customers (Chart 46), it nonetheless needs to be put into perspective as residential loans carry substantial guarantees (see point 1.5 above).

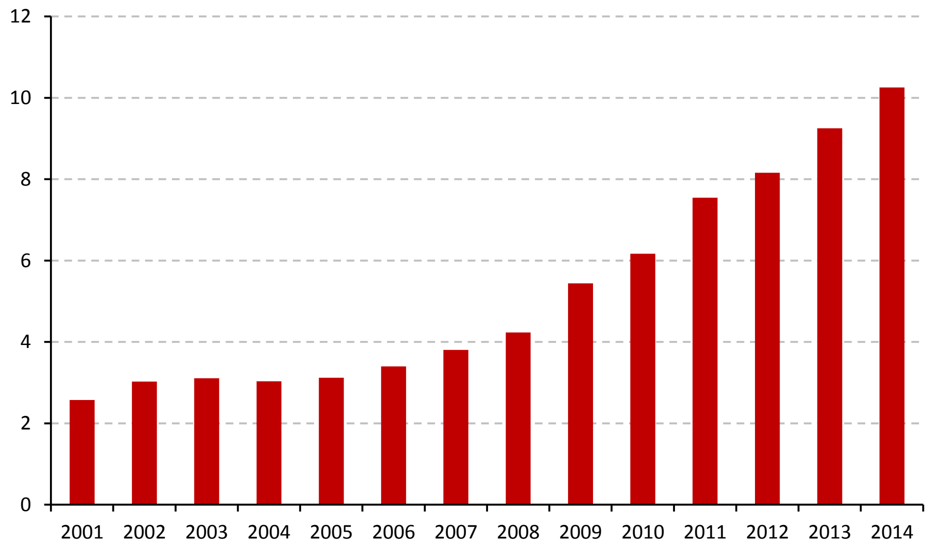
Chart 46
NPL coverage ratio



Source: ACPR, annual survey and banks' accounting data

The slight improvement in the average NPL coverage ratio for residential loans helped to limit the rise in the net amount of non-performing loans (i.e. gross non-performing loans minus impairments); nonetheless, the latter still rose 11% versus 2013, to a total of EUR 10.3 billion (Chart 47).

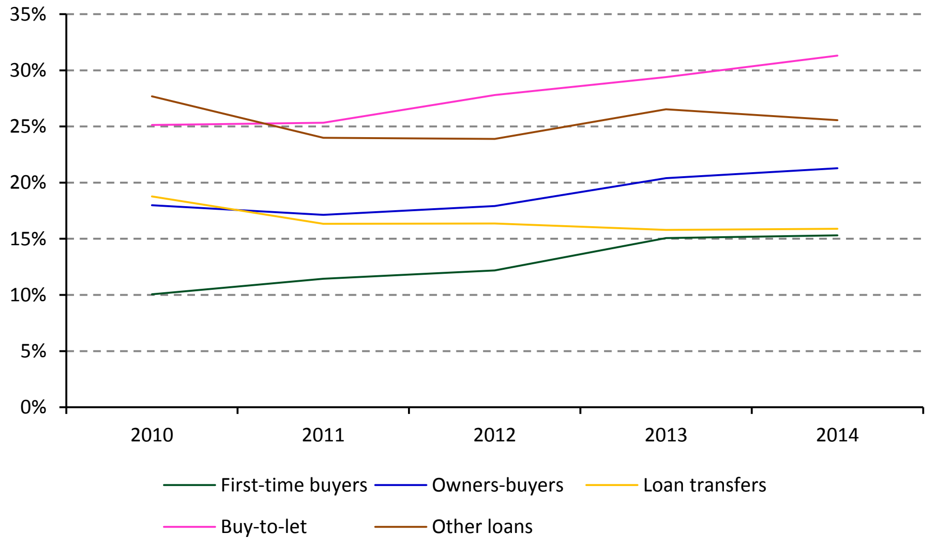
Chart 47
Net non-performing loans, in EUR billions



Source: ACPR, annual survey

As with the gross NPL rate, the coverage ratio tends to vary markedly across market segments, and is not necessarily directly correlated with the actual rate of defaults in that category. Buy-to-let investment loans, for example, which are generally considered to be the highest-risk segment, also have the highest NPL coverage ratio – yet this seems somewhat paradoxical given that borrowers in this segment tend to have relatively high levels of income. In contrast, first-time buyers generally have a relatively low NPL coverage ratio, as a portion of the outstanding loans in this category are secured by SGFGAS. Moreover, coverage ratios for these two segments, and for owners-buyers have risen in recent years, while those for other loans and loan transfers have tended to decline (Chart 48).

Chart 48
Coverage ratio for non-performing residential loans, by market segment



Source: ACPR, annual survey

Lastly, since 2011, coverage ratios for fixed rate and floating rate loans have tended to diverge: the NPL coverage ratio for floating rate products has risen at a much faster pace and now stands well above that for fixed rate loans, potentially reflecting the higher level of risk exposure on this type of loan (Chart 49).

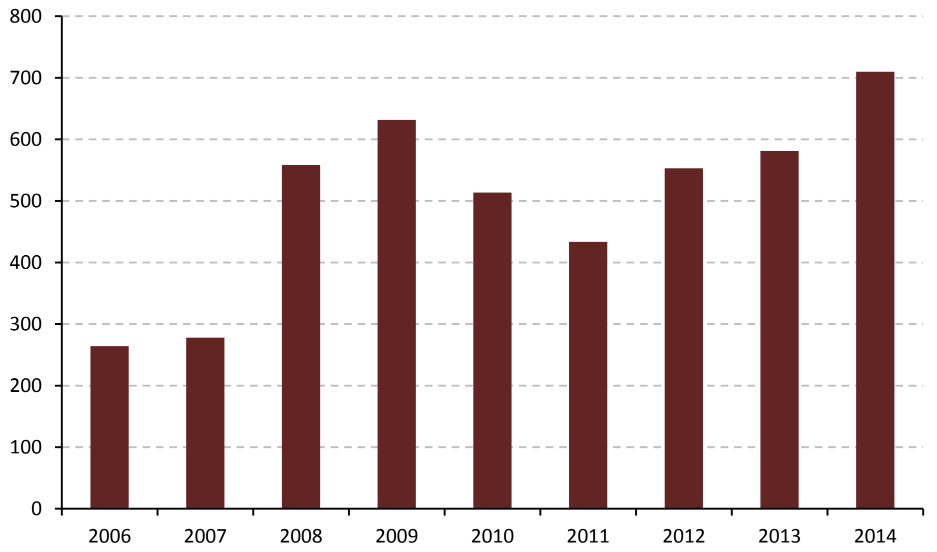
Chart 49
Coverage ratio for non-performing residential loans, by rate type

Source: ACPR, annual survey

3.2.3. The cost of risk has risen but remains well covered

The overall cost of risk[16] for residential lending to individuals has been rising since 2011, and in 2014 hit EUR 710 million, exceeding its 2009 peak (EUR 632 million; Chart 50). This nonetheless masks significant divergences, with six banks in the survey reporting a decline in their cost of risk between 2013 and 2014, of between -20% and -30%.

Chart 50
Cost of risk (in EUR millions)



Source: ACPR, annual survey

The ratio of the cost of risk to total outstanding residential loans (which increased over the period) has also risen since 2011, and stood at 0.088% in 2014. However, this remains slightly lower than 2009's level of 0.101%. In addition, the cost of risk

[16] The cost of risk is equal to net provisions for non-performing residential loans and net losses on residential loans.

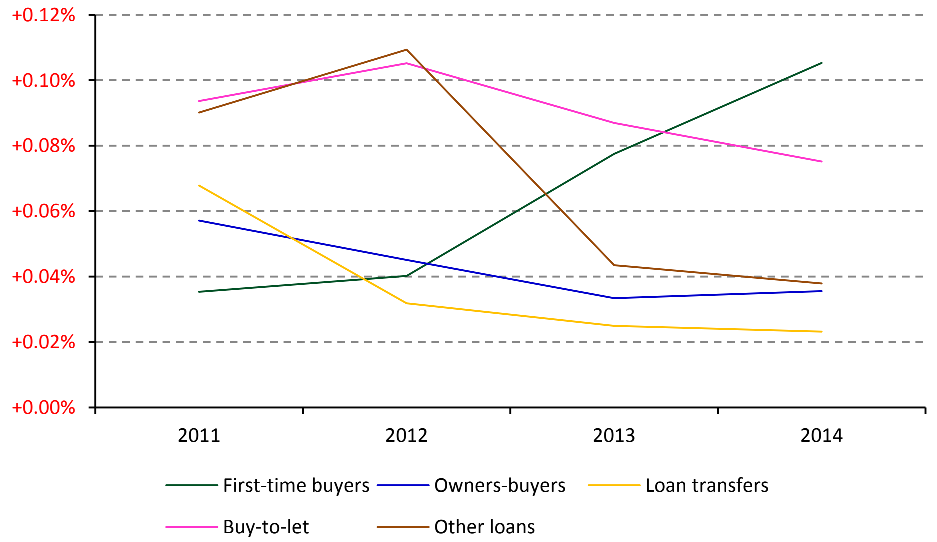
ratio for residential lending remains well below the overall ratio for France's main banks, even though the two indicators have followed opposite trends since 2011 (Chart 51).

Chart 51
Cost of risk/average outstanding loan stock

*Source: ACPR, annual survey; banks' financial disclosures; *cost of risk of the 6 main French banking groups as a ratio of their total balance sheet*

Based on the survey responses, which only covered a limited portion of the market, it appears that the rise in the cost of risk ratio is almost exclusively attributable to first-time buyers: the ratio for this segment has tripled since 2011 and now exceeds the levels observed in the rest of the market. At the same time, the cost of risk ratio for all other segments has trended downwards over the past four years, despite the slight rebound for owners-buyers between 2013 and 2014 (Chart 52).

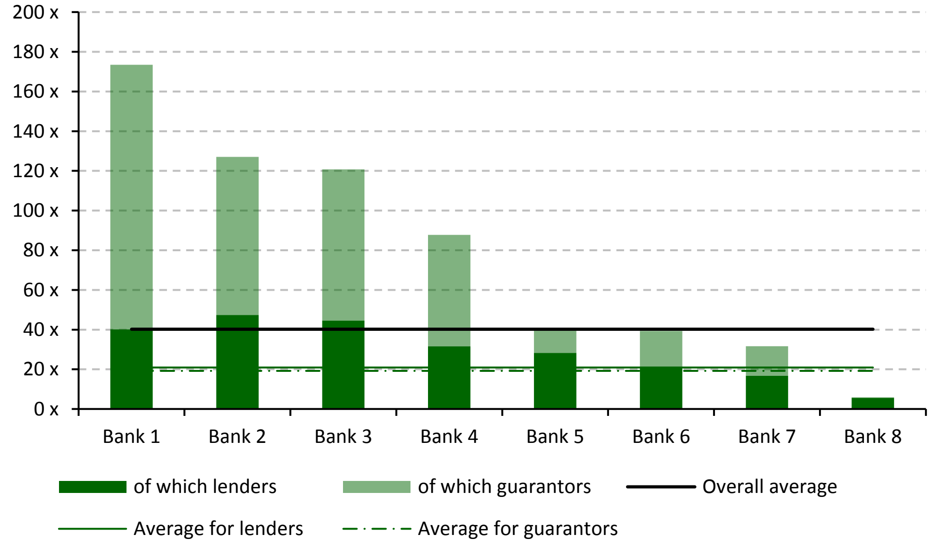
Chart 52
Cost of risk/average outstanding loans, by market segment



Source: ACPR, annual survey

Although the overall cost of risk for residential lending has risen in the past four years, French banks still have more than enough available reserves to cover their exposure (see Methodology 2): although divergences between individual data should be treated with caution due to the limited nature of the survey, at end-2014, French banks had sufficient reserves to cover their long-term average cost of risk[17] for 40.2 years (see black horizontal line in Chart 53).

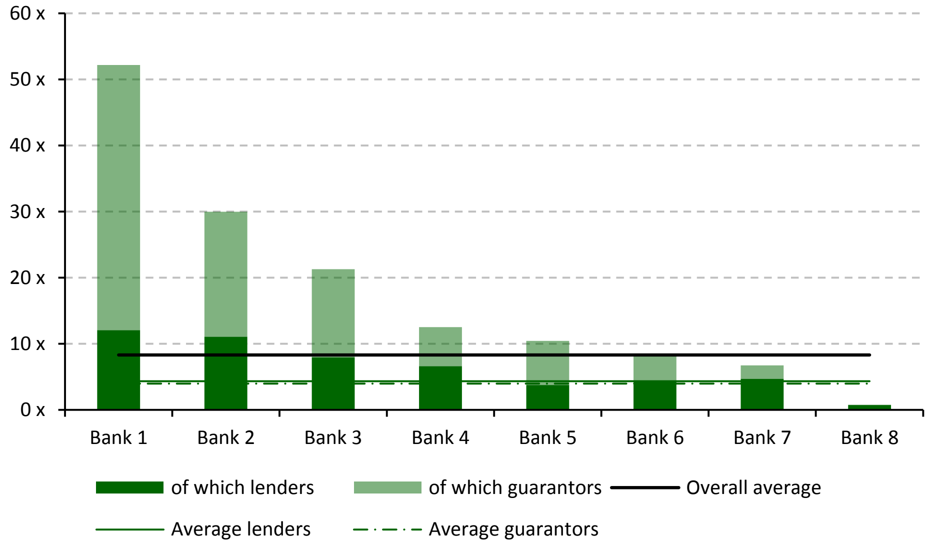
Chart 53
Coverage of average annual cost of risk



Source: ACPR, annual survey, SURFI, COREP and data from insurers

Even under a stress test scenario, consisting in a sharp rise in net provisions for residential loans and net losses on these loans,[18] French banks would still have sufficient reserves to cover their cost of risk for an average of 8.3 years (Chart 54).

Chart 54
Coverage of average annual cost of risk under a stress test



Source: ACPR, annual survey, SURFI, COREP and data from insurers

Methodology 2:
Estimation of French banks' available reserves to cover residential loan risk

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17 Average annual cost of risk since 2006.

18 First, for each bank, we calculated the 99% quantile of the annual variations in its cost of risk since 2006, assuming that the distribution of these variations follows a normal law. The stressed cost of risk is then estimated by applying the previously calculated growth rate to the 2014 cost of risk. According to the surveyed banks, this stress corresponds to a rise in the cost of risk of between 153% and 740% in relation to its average.

French banks can use the following resources to offset their risk exposure on residential lending:

- Own funds allocated specifically to the coverage of residential loan risk; this is deemed to be equivalent to their capital adequacy requirement for risk exposure on retail loans – excluding SMEs – secured by property, as indicated in COREP reports, for France;
- For guarantors qualifying as credit institutions, the guarantee funds set aside by the borrowers, net of any amounts already used to offset non-performing loans or anticipated losses, and other items of capital specifically allocated to the coverage of residential loans;
- For guarantors qualifying as insurance undertakings, technical reserves set aside to secure residential loans and the corresponding margin requirements;
- For outstanding loan balances secured by SGFGAS, State guarantees.

As bank lending is generally secured by several different types of guarantee, individual banks usually have access to more than one of the above resources. Similarly, a single guarantor may have secured the loan books of several different banks; in this case, the guarantor's own funds and other resources are distributed on a pro rata basis, according to the amount of guaranteed lending held by each bank.

At the time of writing of this report, a full set of data had not yet been collected on four of the surveyed guarantors, including three credit institutions, while for the other establishments, the required data were not necessarily available at end-2014. As a result, data from 2013 were used. In addition, SGFGAS guarantees were not taken into account as the figures reported by the banks were in all probability incorrect (see point 1.5 above). Lastly, given the huge difficulties associated with estimating the profitability of residential loans, the future returns banks may derive from their loan books were not taken into account.

3.3. Risk exposure remains primarily concentrated on first-time buyers

Table 2 lists the values calculated for each of the previously discussed risk indicators, for each segment.[19] The risk indicators may be grouped into two subsets: *ex ante* (first four criteria in the table) and *ex post* (last three criteria).

Table 2
Risk estimates for each market segment in 2014

12/31/2014	First-time buyers	Owner-buyers	Loan transfers	Buy-to-let	Other loans	Île de France	Provinces
Average borrower income at origination	0.86	0.57	0.43	0.71	0.29	0.14	1.00
Average loan amount at origination	0.71	0.86	0.57	0.29	0.14	1.00	0.43
Average maturity at origination	1.00	0.86	0.29	0.43	0.14	0.71	0.57
Average debt service ratio at origination	0.57	0.86	1.00	0.29	0.14	0.71	0.43
Average LTV ratio at origination	0.57	0.29	0.86	1.00	0.43	0.14	0.71
Average debt to income ratio at origination	1.00	0.86	0.43	0.29	0.14	0.71	0.57
Average 1	0.79	0.71	0.60	0.50	0.21	0.57	0.62
Chg vs. 2013	+0.00	-0.02	-0.02	+0.05	+0.00	+0.00	+0.00
NPL ratio	0.80	0.60	0.20	1.00	0.40		
NPL coverage rate	1.00	0.60	0.80	0.20	0.40		
Cost of risk	1.00	0.40	0.20	0.80	0.60		
Average 2	0.93	0.53	0.40	0.67	0.47		
Chg vs. 2013	+0.07	+0.00	+0.00	-0.07	+0.00	+0.00	+0.00
All criteria	**0.86**	**0.62**	**0.50**	**0.58**	**0.34**	**0.57**	**0.62**
Chg vs. 2013	**+0.03**	**-0.01**	**-0.01**	**-0.01**	**+0.00**	**+0.00**	**+0.00**

Source: ACPR, annual survey and monthly monitoring of new residential loans

[19] Methodology: *n* is the number of segments for which data are available for a given risk indicator (for example, "non-performing outstanding residential loans" data are available for five segments); for this indicator, the score 1/*n* is attributed to the segment which shows the lowest risk level and 1 (or *n*/*n*) to the segment which shows the highest risk level; the overall score of a segment is set as the arithmetical sum of its scores for each risk criterion.

The main areas of risk have changed little compared with last year: first-time buyers are by far the riskiest segment, with a very high risk score and one that is slightly higher than last year (+0.03), reflecting an increased cost of risk (see above). At the other end of the scale, risk exposure appears to be limited on the other loans category. The remaining segments all have scores more or less in line with the average.

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