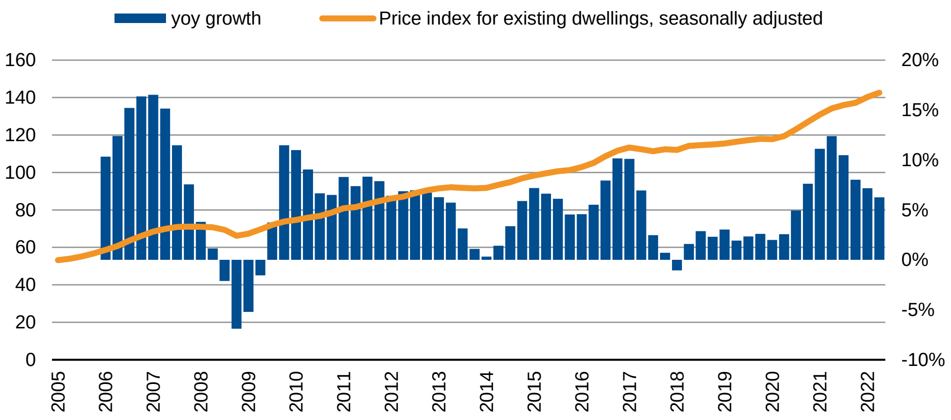
Norway's residential housing boom is over: prices starting to fall

Norway's residential house prices are falling as the economic backdrop deteriorates and the era of ultra-low interest rates ends. This will expose households to an affordability shock, amplified by the floating-rate environment. Banks are entering the more challenging environment from a position of strength, however. Covered-bond collateral has low leverage.

Skid marks have appeared in the rate of growth of Norwegian house prices, which has averaged 5.9% since 2005. The trend has only been interrupted three times: in the 2008 Global Financial Crisis, after the 2014 oil-price shock, and in 2017 when more restrictive rules on mortgage amortisation and a new debt-to-income cap had the intended impact of calming house prices. Prices unexpectedly rose again through the pandemic.

Eiendomsverdi data to October indicate the rally is over. Nominal, unadjusted prices fell nationwide by an average of 1.9% after falling 2.2% a month ago. Reinforcing the end-of-rally thesis is the trend reversal in property sales. In earlier vintages, the number of unsold properties following the sluggish summer period fell again or stagnated. Now, the stock of unsold property increased. Compared to one year ago, September sales went down by 8.2%.

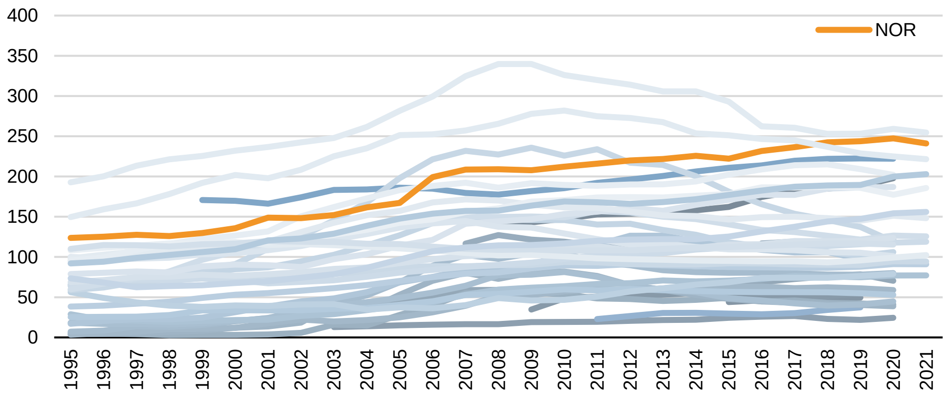
Figure 1: Price index for existing dwellings, seasonally adjusted



Sources: Scope Ratings, Eurostat

On affordability, high house prices have pushed Norway's debt-to-income ratio to 240%, the second highest on an international peer comparison basis and only slightly below Denmark. However, unlike in Denmark and the Netherlands (where DTI is also high), Norway's ratio has risen steadily in the last 26 years, with only a small decline in 2021.

Figure 2: Household debt to income (% of disposable income)



Source: Scope Ratings, Eurostat

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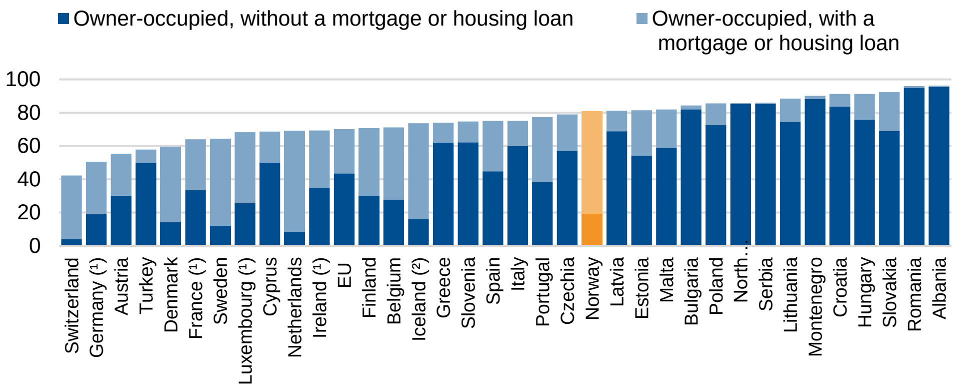
Affordability shock beckons

High rate of owner-occupancy paired with tax incentives drives up DTI ratio

One of the principal reasons Norwegians have a high DTI ratio stems directly from the country's high rate of owner occupancy, paired with tax incentives: 81% of Norwegians are property owners and 62% have mortgages, the highest share in Europe. The high correlation between property ownership and mortgages is to some extent incentive-driven in the form of generous tax deductibility on interest payments. The IMF's September Report on Norway encouraged a gradual phasing out of mortgage interest deductibility, although that will struggle to find political support in the current tense situation.

Figure 3: Population distribution by tenure (occupancy) status, 2020



Sources: Scope Ratings, Eurostat

Based on 2020 data, 9.4% of Norwegian households have housing costs accounting for 40% of income. That is above the average EU housing "cost over-burden" rate of 7.8 % in 2020. It is worth noting, though, that Norway is by no means an upside outlier on this metric: the rates for Switzerland and Denmark are far higher at 13.6% and 14.1%.

Rates squeeze: 94.7% of mortgages floating rate

But housing costs will significantly increase in Norway, considering that 94.7% of the country's home mortgages are floating-rate. The Norwegian reference rate (Nibor) was around 0.5% for most of 2020 but it now stands at around 3.4%, following the latest policy rate increase to 2.5% as of 3rd of September 2022. A further increase is already indicated to take place in December. Hence, for many of the loans originated during the last years, the mandatory 5% rate increase to be tested by Norwegian lenders at origination, provides only a moderate distance to the actual rate environment. The affordability cushion above that level is uncertain.

Figure 4: Household net wealth

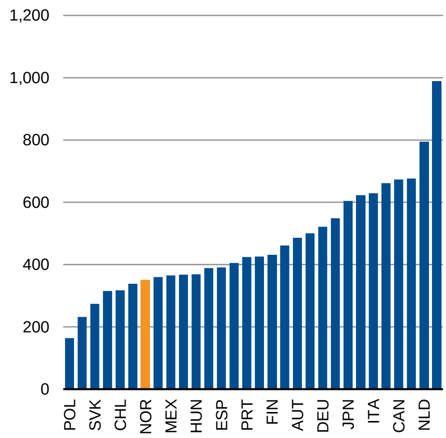
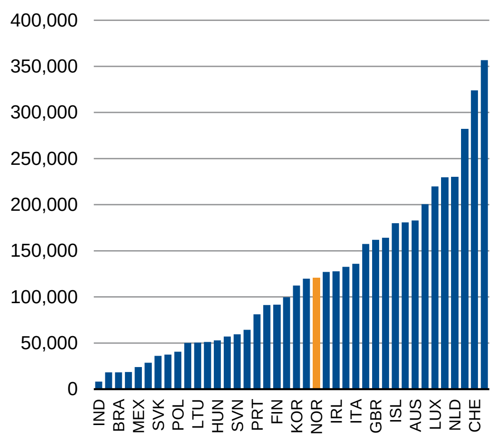


Figure 5: Household financial assets

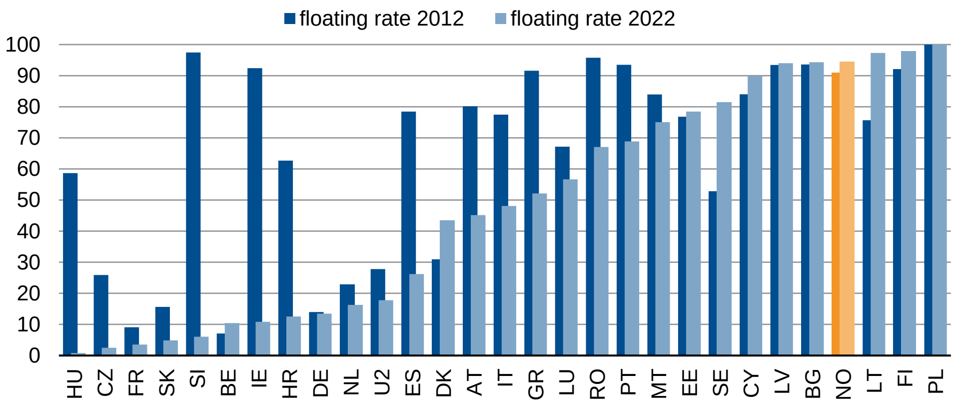


Source: Scope Ratings, OECD

On the other hand, affordability has been facilitated by high income: Norwegians rank Top 4 by income. But personal wealth is debt-constrained. Norwegians' net worth (i.e. assets minus the debt associated with them) is below average. Falling house prices will put even more pressure on this metric. Household financial assets are also average.

As a consequence, rising rates will present a significant dent to affordability and household wealth in Norway. In fact, the proportion of floating-rate mortgages has even increased, running counter to the trend in countries such as Austria, Italy and Spain where homeowners have locked in fixed rates at historical lows in recent years.

Figure 6: Variable-rate loans to total loans for house purchase (new business)



Source: Scope Ratings, ECB

Strong economic fundamentals

Negatives softened by economy and SWF safety net

While the combination of high debt, moderate liquid assets and floating-rate loans will have consequences on loan performance, we take comfort from Norway's strong economic fundamentals. The unemployment rate inched down to 3.2% in the third quarter of 2022, from 5.4% during the peak of the pandemic. The sovereign wealth fund provides an enormous safety net should households suffer more than expected. At the same time, if the house-price boom is over, as would appear to be the case, Norwegians face trouble on the horizon.

Cover-pool leverage improved as average LTV reduced

Strong value cushion built up in last few years

Accelerated increases in house prices have had a generally positive impact on banks' mortgage books in recent years as they have pushed up the proportion of low-LTV loans extended by Norwegian covered bond issuers by 20pp. The share of loans with LTVs below 60% was around 55% in 2020. Today, it is 75%. This provides a strong cushion against potential declines in values. Consequently, the collateral cushion for the country's covered bonds is very strong and able to absorb high price declines before any losses are crystallised.

No negative impact on covered bonds' stressed recovery rates

Stressed Market Value Decline adopts earlier unsustainable house-price increases

We do not expect the fall in housing valuations to have a negative impact on recovery rates used in our covered bond risk analysis. Recoveries are calculated by applying Market Value Decline assumptions on property values. These are a function of sustainable long-term growth and current valuations. Scope's value decline assumptions increase when prices grow above our sustainable long-term growth assumptions.

Figure 7: Oslo value declines

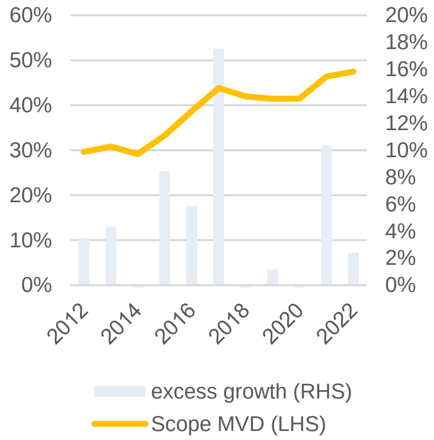
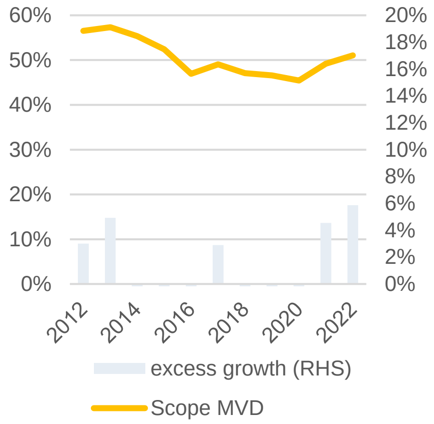


Figure 8: Stavanger value declines



Source: Scope Ratings

We have increased our Market Value Declines for Oslo by 20 percentage points over the last 10 years, and decreased them by 5% for Stavanger, because house prices have grown only marginally or have declined. Our stressed recovery rates will generally remain stable as most of the increase (i.e. above what we believe is sustainable growth) will be cut using our Market Value Declines.

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