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Reykjavík, 20 June 2017

Financial Stability Council opinion on rules concerning maximum loan-to-value ratios

The Financial Stability Council provides an opinion on the Financial Supervisory Authority's maximum loan-to-value ratios for residential mortgage loans in accordance with Article 25, Paragraph 1 of the Act on Mortgage Lending to Consumers, no. 118/2016.

If financial stability is considered under threat because of imbalances in the real estate market, it is permissible to impose maximum loan-to-value (LTV) ratios or to set caps on loan amounts or debt service-to-income ratios in order to mitigate or reduce the likelihood of shocks. The objectives of applying these instruments are of two types: on the one hand, to affect demand for credit, and on the other, to preserve or enhance financial institutions' and households' capacity to withstand reductions in real estate market values even though credit growth may be moderate.

At a meeting of the Financial Stability Council on 20 June 2017, a draft of the Financial Supervisory Authority's rules on maximum LTV ratios for mortgage loans was presented, together with an analysis of the effects of applying the rules. Real house prices have risen rapidly in the recent term and are very high in historical context. Mismatches have developed between house prices and their economic determinants. It has also emerged that credit institutions eased their lending requirements in the wake of increased competition in the mortgage market with a rise in pension funds' lending activity. In spite of this, growth in household debt has been modest in recent years. There is uncertainty about continued price increases. If the supply of newly constructed properties does not increase significantly, prices will probably rise still further. Households' scope to take on additional debt has increased as house prices have risen. As a result, higher house prices can stimulate credit growth, which in turn can fuel further price rises.

Current conditions in the residential housing market warrant protecting the resilience of both financial institutions and customers who borrow while real estate prices are high. Given that credit growth is still deemed modest, the maximum LTV ratios proposed in the rules presented to the Financial Stability Council were set with the aim of enhancing lenders' resilience to a possible turnaround in real estate prices.

According to Article 25, Paragraph 2 of the Act on Mortgage Lending to Consumers, it is permissible to impose different LTV ratios for different types of loans, and increased scope shall be granted to first-time buyers. As a result, the rules allow for a higher maximum LTV ratio on first-purchase loans than on others. The maximum ratios proposed in the rules are in line with those currently used by the banks: 85% for all loans except those granted to first-time buyers, who are subject to a maximum LTV ratio of 90%.

The Council is of the opinion that, in the form in which they were presented at the 20 June 2017 meeting, the rules are conducive to addressing conditions that could jeopardise financial stability or could have adverse effects on the financial system, in that they enhance households' and financial institutions' resilience to a reduction in real estate prices.