



SPI Project:

Mortgage Loans Database

Regulatory Impact Assessment
Approach Note

Background* - 1

Basel II Capital Accord provides that loans fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented, can be risk weighted at 35% (instead of 50%).

In order to apply the 35% risk weight to loans for residential purposes, the supervisory authorities should satisfy themselves, according to their national arrangements for the provision of housing finance, that this concessionary weight is applied restrictively for residential purposes and in accordance with strict prudential criteria, also based on the default experience for these types of exposure.

In parallel, Basel II provides that, in exceptional circumstances for *well-developed and long-established markets*, the mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive a preferential risk weight of 50% (instead of 100%) for the part of the loan that doesn't exceed the lower of 50% of the market value or 60% of the mortgage lending value of the property securing the loan.

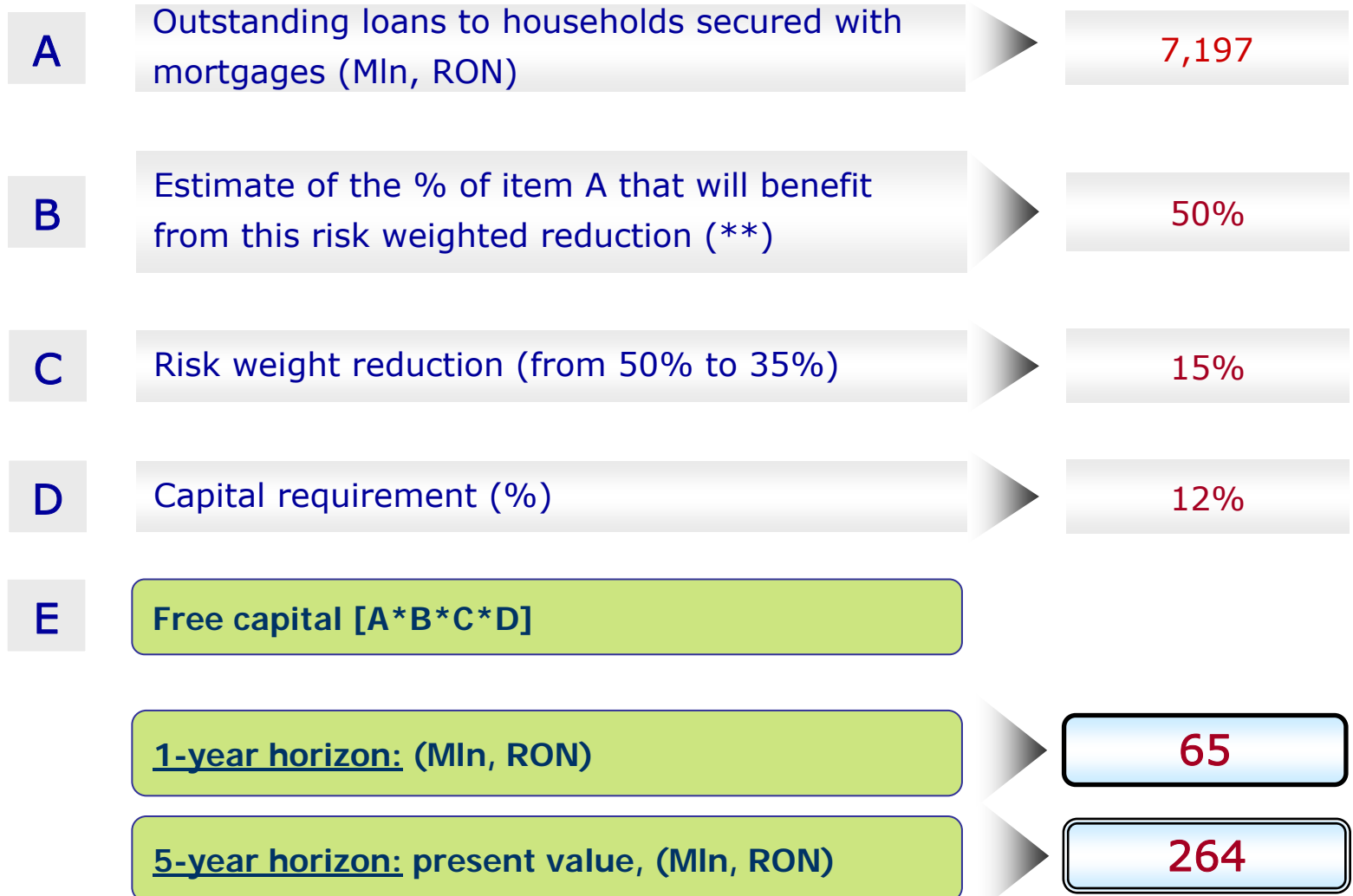
Background* - 2

In order to apply this risk weight, two conditions have to be fulfilled: i) losses stemming from commercial real estate lending up to the lower of 50% of the market value or 60% of loan-to-value based on mortgage-lending-value must not exceed 0,3% of the outstanding loans in any given year; ii) overall losses stemming from commercial real estate lending must not exceed 0,5% in any given year.

The application of this more favorable regime for the loans secured by mortgages would decrease the minimum capital requirements and, consequently, lending costs. In order to benefit of the New Accord on Capital provisions, the banking system should create and maintain an industry database that allows the calculation of the following ratios: default rate and recovery rates for loans secured by mortgages on residential real estate and, if endorsed by the National Bank of Romania, also on commercial real estate whose guarantee value is up to 50% of the market value respectively. The database should gather also information on the real estate market (market values of real estate properties).

Economic impact assessment - 1

i - Section on residential real estate



Economic impact assessment - 2

ii - Section on commercial real estate

F	Current medium- and long-term loans (Mln, RON)	27,934
G	Share of loans backed by commercial property (%)	30%
H	Outstanding loans fully secured by mortgages on commercial property (Mln, RON) [F*G]	8,380
I	Estimate of the % of item H that will benefit from this risk weighted reduction (**)	20%
J	Risk weight reduction (from 100% to 50%)	50%
K	Free capital [A*B*C*D]	
	<u>1-year horizon:</u> (Mln, RON)	100
	<u>5-year horizon:</u> present value, (Mln, RON)	411

Economic impact assessment - 3

iii - Section on market development

L	Average pricing of a residential mortgage loan (%)	11%
M	Average pricing of a commercial mortgage loan (%)	12.6%
N	Reduction of residential mortgage loan pricing as a result of less capital absorbed (p.p.)	0.18 p.p.
O	Reduction of commercial mortgage loan pricing as a result of less capital absorbed (p.p.)	0.6 p.p.
P	Change in the demand for credit that happens due to change in lending interest rates (%)(*)	(0.1)

*= Shows percentage change in the demand for credit when interest rate changes by one percent

Economic impact assessment - 4

iii - Section on market development

Q

Potential increase of demand for residential mortgage loans (MIn, RON)

1-year horizon: (MIn, RON)

6

5-year horizon: present value, (MIn, RON)

24

R

Potential increase of demand for commercial mortgage loans (MIn, RON)

1-year horizon: (MIn, RON)

40

5-year horizon: present value, (MIn, RON)

163

Q

Overall interest income (MIn, RON)

1-year horizon: (MIn, RON)

5.4

5-year horizon: present value, (MIn, RON)

22.2

Analytics - 1

Residential	Outstanding loans to households secured with mortgages (Mln, RON)	a)	7,197
	Estimate of the % of item A that will benefit from this risk weighted reduction	b)	50%
	Risk weight reduction (from 50% to 35%)	c)	15%
	Capital requirement (%)	d)	12%
	Free capital [Mln, RON]	e)=a*b*c*d	65
Commercial	Current medium- and long-term loans (Mln, RON)	f)	27,934
	Share of loans backed by commercial property (%)	g)	30%
	Outstanding loans fully secured by mortgages on commercial property (Mln, RON)	h)=f*g	8,380
	Estimate of the % of item H that will benefit from this risk weighted reduction (%)	i)	20%
	Risk weight reduction (from 100% to 50%)	j)	50%
Market development	Free capital [Mln, RON]	k)=d*h*i*j	100.6
	Average pricing of a residential mortgage loan (%)	l)	11.0%
	Average pricing of a commercial mortgage loan (%)	g)	12.6%
	Change in the demand for credit that happens due to change in lending interest rates (%)	h)	(0.1)
	Increase in demand for residential mortgage loans (Mln, RON)	i)	5.9
	Increase in demand for commercial mortgage loans (Mln, RON)	j)	39.9
	Interest income on new residential lending	k)	0.6
Interest income on new commercial lending	l)	4.8	

Analytics -2

		2007	2008	2009	2010	2011	5-year NPV
PV - Capital freed due to residential backed mortgages (MIn, RON)	i)	60.5	56.5	52.7	49.2	46.0	264.9
PV - Capital freed due to commercial backed mortgages (MIn, RON)	ii)	93.9	87.7	81.9	76.4	71.4	411.2
PV - Increase in demand for residential mortgage loans (MIn, RON)	iii)	5.5	5.1	4.8	4.5	4.2	24.1
PV - Increase in demand for commercial mortgage loans (MIn, RON)	iv)	37.3	34.8	32.5	30.3	28.3	163.2
PV - Interest income on new residential lending (MIn, RON)	v)	0.6	0.6	0.5	0.5	0.5	2.6
PV - Interest income on new commercial lending (MIn, RON)	vi)	4.5	4.2	3.9	3.6	3.4	19.6

Discount rate (%)	7.10%				
Discount factor	0.933707	0.871808	0.814013	0.76005	0.709664

Analytics - 3

Data and assumptions:

- a) Real-estate/mortgage loans to households (Mln, RON) 7,197
Source: NBR, *Financial Behaviour of Households and Companies*, September 2006
- b) Residential mortgage lending: Real-estate/mortgage loans to households are considered 100% residential property
- c) Estimate of the % of loans fully secured by mortgages on residential property that will benefit from this risk weighted reduction 50%
- d) Commercial mortgage lending: calculations of this item are based on
- i) Current medium- and long-term loans(Mln, RON) 27,934
 - ii) Weight of loans backed by commercial property (%) 30%
- e) Estimate of the % of loans fully secured by mortgages on commercial property that will benefit from this risk weighted reduction 20%
- f) Average pricing of a residential mortgage loan (%) 11.0%
Source: NBR, *Monthly Bulletin-Statistical Section*, 9/2006, p. 19
- g) Average pricing of a commercial mortgage loan (%) 12.6%
Source: NBR, *Monthly Bulletin-Statistical Section*, 9/2006, p. 19
- h) Reduction of residential mortgage loan pricing as a result of less capital absorbed. It is calculated as follows:
- i) loan=100
 - ii) differential risk weight=15%
 - iii) capital adequacy ratio=12%
 - iv) cost of equity=10%
 - v) cost of equity as pricing component= **0.18%**
- i) Reduction of commercial mortgage loan pricing as a result of less capital absorbed. It is calculated as follows:
- i) loan=100
 - ii) differential risk weight=50%
 - iii) capital adequacy ratio=12%
 - iv) cost of equity=10%
 - v) cost of equity as pricing component= **0.6%**
- j) Estimated interest elasticity(*) of the demand for mortgage loans (%) -10%