

Adjustments in the real estate sector following the revision of the loan-to-value (LTV) measure

During 2017 – 2018, there was a build-up of vulnerabilities in the real estate sector, particularly in the mortgage loan market. This was due to higher competition in loan extension among financial institutions, resulting in deteriorating credit underwriting standards. In some cases, there were no requirements for borrowers to make down payment or to have savings before acquiring loans. In other cases, financial institutions extended loans with value exceeding collateral value. Moreover, there were speculative signs from real estate purchases, expecting returns without real demand in the property. Property was instead rented or invested with an expectation of future price increases. Speculative demand from these buyers caused real estate prices to rise faster than growth of average household income. Thus, buyers with real demand had to buy real estate at higher prices. Meanwhile, real estate developers continued to raise funds in order to expand businesses. In addition, excessive competition among financial institutions and developers might accelerate speculation in the real estate sector and increase risks to macroeconomic and financial stability in the future.

The Bank of Thailand (BOT) recognized the importance of such issue since the real estate sector was one of the root causes of financial crises around the world. The BOT thus implemented a preventive measure to address systemic risks through the revision of the loan-to-value (LTV) measure. Key revision^{12/} included a more tightened ceiling of the loan-to-value (LTV) ratio for second and subsequent mortgage contracts, or for residential units with value exceeding 10 million baht. The revised measure became effective on 1 April 2019. This measure aims to enhance credit underwriting standards of financial institutions in order to emphasize lending to residential buyers with real demand, as well as to address over-indebtedness issue and speculation in the real estate market. Therefore, buyers with real demand would be able to buy residential units at more affordable prices.

After the implementation of LTV measure, the real estate market was affected from a slowdown in external demand and softening domestic economy. The BOT had been closely monitoring adjustments of related parties and found that households, financial institutions, and real estate developers had adapted themselves in accordance with the objectives of this measure as follows.

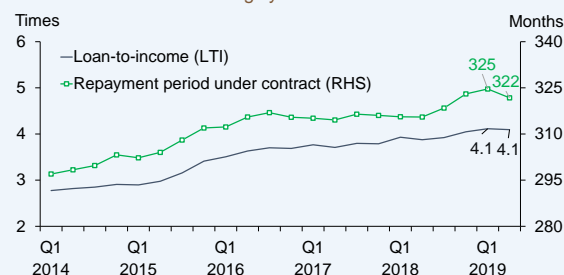
(1) Credit underwriting standards among financial institutions became more tightened, particularly mortgage contracts on second and subsequent residential units acquired by the same purchaser. However, there was a limited impact on first contract borrowers. This was reflected by a decline in average LTV ratio of mortgage contracts on second and subsequent residential units from 87.8 percent in the first quarter to 83.1 percent in the second quarter of 2019, while the ratio of first mortgage contracts remained at 88.5 percent (Chart 1). Moreover, the repayment period started to taper off. The average loan-to-income ratio was largely stable. (Chart 2)

Chart 1 Average loan-to-value (LTV) ratio in the banking system



Note: Calculated from the database on loans that use new housing as collateral
Source: Bank of Thailand

Chart 2 Average loan-to-income (LTI) ratio and repayment period under contract of the banking system



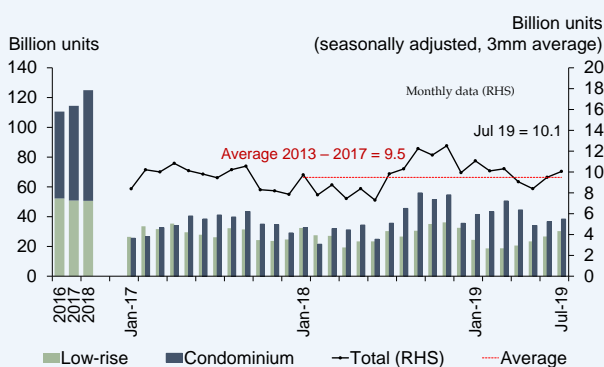
Note: Calculated from the database on loans that use new housing as collateral
Source: Bank of Thailand

^{12/} For more detail, https://www.bot.or.th/Thai/FinancialInstitutions/Publications/Pages/HousingLoan_Notification.aspx

(2) Speculation in the real estate market was subdued, as reflected by a contraction in a number of new mortgage contracts during the first half of 2019. In particular, a number of new mortgage loans on second and subsequent contracts, especially for high-rise residential units, fell 25.0 percent. (Table 1) However, a number of first mortgage contracts still expanded 14.0 percent. Overall, a number of new mortgage contracts decelerated from a high expansion of 27.9 percent in the first quarter, before the LTV measure took effect, to only 2.4 percent in the second quarter following a sharp decline of 39.0 percent for mortgage loans on second and subsequent contracts.

(3) Residential prices moderated (Chart 3), which partly helped residential buyers with real demand to purchase at a more reasonable price. Credit underwriting standards among financial institutions were more tightened, resulting in demand slowdown. This could partly slow the pace of residential price increases, particularly condominium, whose prices had accelerated significantly in the previous period due to speculation.

Chart 4 New residential units launched in Bangkok and vicinities



Source: AREA, calculation by Bank of Thailand

launch a large number of new projects in 2019, both low-rise and high-rise projects, although the figures were somewhat lower than original target set at the beginning of the year. Also, funding through pre-finance and the bond market was expected to rise. Nevertheless, if sales from new project launches were not as expected by developers, especially given the softening outlook of both domestic and external demand, this might increase risks of oversupply and pose liquidity risk for developers going forward. (Chart 4)

Following the implementation of the LTV measure, the BOT had been monitoring the situation and receiving opinions and suggestions from all related parties. The BOT considered a relaxation of this measure in relation to co-borrowers for those who were not registered as owners of the property. This was aimed to mitigate the impact on co-borrowers, most of whom were not high income earners

Table 1 Growth of new mortgage loan accounts extended by financial institutions

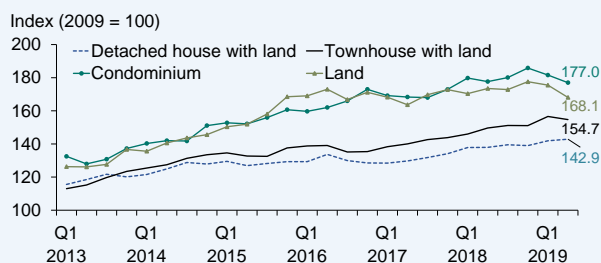
%YoY

	New mortgage loan accounts
Jan – Jun 19	14.2
1 st contract*	14.0
- low-rise*	17.9
- high-rise*	5.8
2 nd and subsequent contract*	-13.0
- low-rise*	3.7
- high-rise*	-25.0
Jan – Mar 19 (Q1/2019)	27.9
Apr – Jun 19 (Q2/2019)	2.4
1 st contract*	-2.9
2 nd and subsequent contract	-39.0

Note: Calculated from the database on loans that use new housing as collateral

Source: Bank of Thailand

Chart 3 Real estate price indices for real estates in Bangkok and the vicinities



Note: Indices are calculated based on database on commercial banks' new loans
Source: Bank of Thailand

(4) Developers adjusted in response to demand slowdown by focusing on sales promotion strategies for completed projects in order to release high stock of unsold units, as well as focusing on launches of low-rise residential projects which had shorter time-to-go than condominium projects to realize income faster. However, there remained a need to closely monitor issues on an oversupply in the period ahead despite some adjustments among developers. This was because developers listed in the stock exchange set a target to

and could become potential demand for residential units^{13/}, to acquire mortgage loans in a more appropriate practice. That is, if borrowers were not registered as owners of the property, they would be treated as if they were not borrowers on that contract. This was because they have no real intention to buy the residential property. Co-borrowers might only want to support main borrowers, who were mostly their family members, to acquire mortgage loans from financial institutions. Nevertheless, there remained a need to continue monitoring impacts of the revised LTV measure, as well as adjustments in the real estate sector and oversupply going forward.

^{13/} Co-borrowers applying for new mortgage loans under the first contract accounts for 26 percent, most of which are contracts for low-rise houses with value around 2-5 million baht.