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Danske Bank A/S

Danske Bank's 30-year mortgage loan in Sweden carries moderately higher credit risk than traditional mortgages

On 26 November, Danske Bank A/S (A2/A2 negative, baa1[1]) announced the launch of a 30-year fixed rate mortgage product in Sweden's competitive mortgage market. Although the product will facilitate Danske Bank's growth strategy in Sweden by supporting lending volumes and enhancing the bank's position as a challenger bank, it will likely attract slightly weaker borrowers and thus be associated with moderately higher credit risk than traditional Swedish mortgages.

The product's 30-year fixed interest rate period matches the maturity of the loan and it can be prepaid partially or in full at any time without prepayment fees, providing borrowers with flexibility. The mortgage, launched under the brand name Bolån Stabil, is being offered on a pilot basis to existing customers and is restricted to loans above SEK1 million ($104,000) to fund customers' primary residence.

No other bank offers a similar product in Sweden, where just over 60% of household mortgages have a fixed interest rate period of only three months.[2] Another key difference with the 30-year mortgage loan is that Danske Bank is basing its affordability calculations on the loan's actual 2.89% interest rate and not the 7% stressed interest rate[3] that most Swedish banks apply as part of their underwriting standards when assessing mortgage applications. This will allow borrowers to take on higher debt than would otherwise have been the case. The product will also attract households with moderately lower incomes, including first-time buyers and pensioners, who would otherwise be unable to obtain financing because of the 7% stressed interest rate used for other mortgages.

According to our calculations, a first-time buyer (single household) with a monthly gross income of SEK30,000 would be granted a 30-year mortgage of about SEK2 million under the 5.5x debt-to-income ceiling that Danske Bank applies, compared with a traditional loan of about SEK1.5 million (see Exhibit 1). In this example, the loan amount under the new product is 28% higher than under the more traditional products in the Swedish market. This assumes, though, that a borrower would be able to come up with the additional down payment since mortgages can be maximum 85% of loan-to-value in Sweden.

THIS REPORT WAS REPUBLISHED ON 11 DECEMBER 2019 TO CORRECT THE LOAN AMOUNTS IN THE EXAMPLE WE PROVIDE IN THE FOURTH PARAGRAPH.

Exhibit 1
Danske's new mortgage product will allow borrowers to take on higher debt

First time borrower (85% LTV)				
SEK	Monthly	Annual		
Gross salary	30,000	360,000		
Net salary	21,000			
Subsistence costs	6,910			
Operating expenses (apartment)	2,500			
Max amount available for mortgage	11,590	139,080		
	Interest	Amortisation	Max loan amount	Debt-to-income
Danske Bank new mortgage product	2.89%	3.00%	1,980,000	5.5
Standard product	Stress rate	Amortisation	Max loan amount	Debt-to-income
	7.00%	2.00%	1,545,333	4.3
Difference in amount between two products			28%	

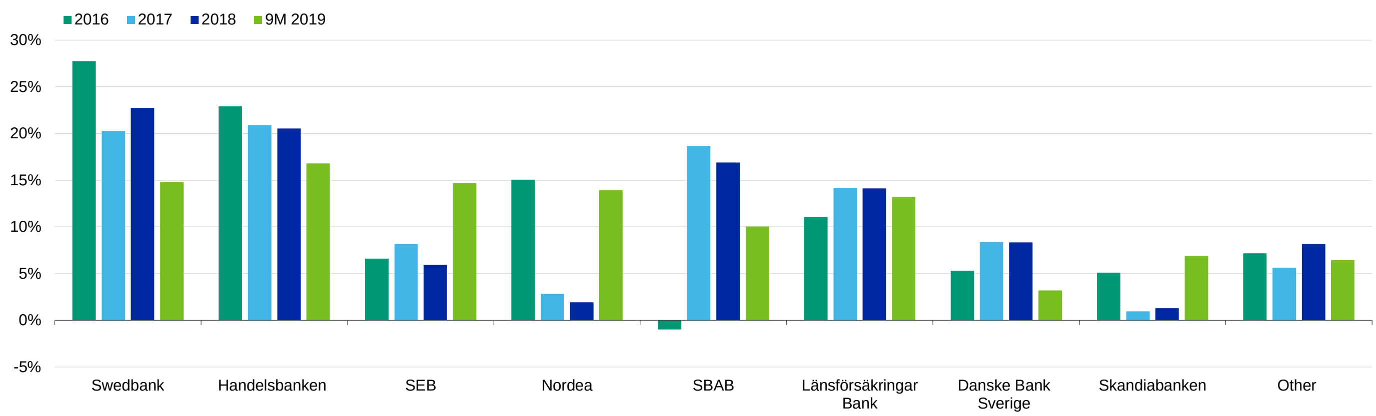
Figures on salary and operating expenses are based on our assumptions; monthly subsistence costs are based on Swedish Consumer Agency estimates for 2018. This assumes that the borrower would be able to come up with the additional down payment since mortgages are maximum 85% loan-to-value.
Source: Moody's Investors Service

The risk is mitigated by Danske Bank continuing to apply the same maximum debt-to-income (5.5x gross income) and regulatory amortisation requirements for mortgage products.[4] The borrowers are also not subject to interest rate risk, because the interest rate is fixed for the entire period of the loan.

The launch of the new mortgage product will support the bank's lending volumes, facilitating its growth strategy in Sweden, one of its core markets, where its share of the outstanding mortgage market is less than 5%.

Competition in Sweden's mortgage market has intensified in recent years, leading to sustained mortgage margin declines since the end of 2017. Danske Bank's mortgage market growth lost momentum this year (see Exhibit 2), with its share of new lending declining to 3% from 8% in 2017-18 as large players, SEB AB (Aa2/Aa2 stable, a3) and Nordea Bank Abp (Aa3/Aa3 stable, a3), offered more competitive pricing.

Exhibit 2
Swedish banks' market shares for new mortgage lending (%)



Source: Statistics Sweden

If Danske Bank's new product becomes more widely adopted in Sweden, it would likely be broadly credit negative for incumbent banks because it would attract slightly weaker borrowers and because Danske Bank may have first-mover advantage. It would also be negative for nonconforming lenders such as BlueStep Bank AB (Baa2 stable, baa2), which are trying to attract borrowers that are unable to comply with the current stressed interest rate.

In addition, widespread take-up of the mortgage would have implications for the system as a whole: household indebtedness (88% of GDP) would increase and the increased demand could lead to renewed upward pressure on house prices. However, households would also become less sensitive to interest rate increases. Thus, in the unlikely event interest rates rose sharply, households would not need to reduce private consumption as much, thereby preventing a fall in GDP growth.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

2 According to the Swedish Central Bank's latest Financial Stability Report.

3 This is not a regulatory requirement but a standard market practice. The stressed interest rate is typically the five-year interest rate plus three percentage points, which generally translates to a level that is 5% above current interest rates.

4 Swedish authorities have introduced an amortisation requirement whereby households borrowing more than 50% of the value of their house are required to amortise at least 1% of their mortgage per year, and those borrowing more than 70% of the value of their house are required to amortise 2% of their mortgage per year. Additionally, borrowers with debt-to-income ratios above 4.5x must amortise an additional one percentage point of their mortgage per year.

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