

Bulgaria

By Petar Ivanov, Tsvetkova Bebov & Partners, member of Eversheds Sutherland

IN A NUTSHELL

- The economy was put under stress by the effects of the political crisis in Ukraine, which resulted in a moderate GDP growth and a 13.7% increase of inflation y-o-y.
- Despite rising house prices and the cost of living, historically low interest rates and increasing income continued to fuel the growth of the mortgage market.
- In the first months of 2023, a slow increase in interest rates on new mortgage loans and a decreased demand stabilized house prices, after over a decade of sustained growth.
- Two new acts of legislation aim at improving conditions for the issuance of securitisations and covered bonds.
- The National Recovery and Resilience Plan will create new opportunities for homeowners to improve the energy efficiency of their buildings.

MACROECONOMIC OVERVIEW

The economy was put under stress by the economic effects from the political conflict in Ukraine and the sanctions imposed on and by Russia, which disrupted supplies of energy and certain raw materials and contributed to a sharp rise of inflation. The country's projected real GDP increase is 3.4% (to EUR 84,6 bn) compared to a 7.6% growth in 2021. This projection is comparable to the EU average GDP growth rate of 3.5% (3.5% in the Eurozone).

There was a sharp increase of inflation with the HICP up to 13% y-o-y (2.8% in 2021), mainly driven by energy, food and services prices. The unemployment rate remained historically low at 4.3%, significantly lower than the EU average of 6.2% (6.8% in the Eurozone). The increase in inflation and shortage of qualified labor contributed to further growth of average wages, which increased 13.7% (26.6% compared to 2020).

LOOKING AHEAD

It is expected that the factors dampening the overall economic performance will persist and will slowly move towards recovery in 2024.

According to its spring economic forecast, the European Commission expects real GDP growth in 2023 of 1.8% (1.0% in the EU and 1.1% in the Eurozone) and projects a moderate decrease of inflation to 9.4% (6.7% in the EU and 5.8% in the Eurozone). As of April 2023, inflation remains high at 13.9%, y-o-y. It is expected that wage growth will slow and remain lower than average inflation, while the unemployment rate will remain low.

After yet another record-breaking year for the Bulgarian housing market (in terms of prices and volume), the first signs of slowing down will occur in 2023 with a slow decrease in demand, more moderate growth in prices and a slight

increase in interest rates to 2.62% for BGN denominated loans (3.69% for EUR denominated loans) in April 2023, which is expected to rise to around 4% by year end. The comparably low interest rates and high inflation will likely continue to support the local housing market and will help to moderate the expected decrease in activity.

HOUSING MARKETS

The growth of the housing market over the past 10 years has peaked. There was an increase in the number of issued building permits – 8,169 (7,047 in 2021 and 5,860 in 2020), the largest number of new building permits issued in Bulgaria since 2008 (10,157). Housing starts increased to 5,468 compared to 5,084 in the previous year, and housing completions also increased to 5,390 compared to 3,898 in 2021. These developments contributed to a 23.5% increase in the volume of new gross residential lending from BGN 5.4 bn (ca. EUR 2.8 bn) in 2021 to BGN 6.7 bn (ca. EUR 3.4 bn).

The steep rise of inflation and sustained demand further accelerated the increase of house price levels, which averaged at 170% of the index's base value in 2015 compared to 149.2% in 2021, they peaked at 175.1% in Q4.

The housing market shows large regional differences. The HPI for the two largest cities – Sofia and Plovdiv - outperform the nation's average and reached an average of 194.2% (152.2% in 2021) and 177% (160% in 2021), respectively. At the opposite end is the fourth largest city – Burgas and the South-east region of Bulgaria with HPIs of 148.8% and 143.1%, respectively. There were higher average wages and more diverse job opportunities in the largest cities – for instance, the average wage in Sofia was 37% higher than the nation-wide average, contributing to asymmetric price increases.

Similarly, to the housing market, the rental market continues to display discrepancies with a steady increase of prices and demand in Sofia compared to the other regions, for the same reasons.

MORTGAGE MARKET

MARKET DYNAMICS

There has been sustained growth of mortgage lending volumes and lowering of interest rates for over a decade, starting in 2010 with a slow recovery following its major crash from 2008/2009 as a result of the global economic crisis of 2008. 2022 marked the peak as the mortgage market grew by 16% compared with 2021 to a total outstanding of BGN 18.4 bn (ca. EUR 9.4 bn). The amount of new lending has grown at a higher pace – 23.5% compared with 2021. Interest rates on mortgage loans followed the trend from preceding years and decreased further to an annual average of 2.54% for BGN denominated loans (2.71% in 2021) and 3.11% for loans in EUR (3.27% in 2021), both reaching an all-time low. This contrasts to the sharp increase in interest rates observed in most EU countries, following the monetary decisions of major central banks, such as the European Central Bank and the Bank of England, and due to the excess

liquidity in the Bulgarian banking sector, kept banks' funding costs low. In Q4 2022 interest rates started to slowly increase (2.63% in December 2022) signalling a likely cooling off of the local market. This trend has continued in the first months of 2023.

The most popular new loan products have floating interest rates (95%), and a large majority are BGN denominated (93% of all outstanding loans and 97% of new loans) due to the more favourable interest rate terms on BGN loans, which comes despite the country's declared goal of joining the Eurozone no later than 2025. The maximum maturity for new mortgages is 35 years with an average of 20 – 25 years. Due to the rise in inflation and housing prices the average borrowed amount on new loans has increased to around BGN 150,000 (ca. EUR 76,600) with an LTV of 80%.

The housing NPL levels continued to decrease in 2022 to 2.33% (BGN 428 m) of all outstanding mortgage loans (3.6%, BGN 573 mn in 2021).

On the supply side, credit standards for house purchases in 2022 remained largely unchanged and relatively relaxed. This comes despite an explicit warning by the Bulgarian National Bank against the application of loose credit standards and a 1% increase of the countercyclical capital buffer for exposures in Bulgaria made by the Bulgarian National Bank in the course of 2022.

NON-MARKET LED INITIATIVES AND FURTHER IMPORTANT EVOLUTION

In 2022, the main non-market led drivers of demand on the Bulgarian market were the fear from the rising inflation and borrower's desire to convert savings into a housing investment, which is perceived as a "safe haven" in an environment marked by a series of regional and domestic crises, marked by political instability both at regional and domestic levels with the ongoing conflict in Ukraine as well as the absence of a stable government in the last two years following political impasse.

MORTGAGE FUNDING

Bank funding is dominated by deposits. As at the end of 2021, the banking sector had BGN 134 bn (ca. EUR 68.6 bn) in deposits (2021 – BGN 115 bn), equal to 81% of GDP and 86% of banking assets. Household deposits account for BGN 74 bn (EUR 38 bn) or 55% of the total, followed by deposits of non-financial entities – BGN 43bn (EUR 22 bn) or 32%, and deposits of financial entities – BGN 12.6 bn (EUR 6.4 bn) or 9.4%.

This dominance of deposit funding is mainly due to the well-established preference of households and non-financial entities to keep their free funds in bank deposits but is also likely a consequence of the underdevelopment of the Bulgarian capital market. The growth in deposits is also a result of the strengthening of consumer confidence in the banking system in recent years.

On the other hand, typical wholesale funding tools such as securitisations and covered bonds are practically non-existent in Bulgaria. The same applies to central bank funding, which may be provided only in strictly limited cases due to the pegging of the Bulgarian Lev to the Euro. Whereas the lack of appropriate legal infrastructure has so far hindered the successful issuance of securitisations, mortgage bonds – a type of covered bonds – did not manage to establish themselves as successful and marketable products despite the issuance of several mortgage bond programmes and stand-alone issues in the late 00s and early 10s. The last mortgage-backed bonds issue by a Bulgarian bank matured in September 2019.

In March 2022, the Bulgarian parliament adopted the new Covered Bonds Act, which replaced the existing mortgage-backed bonds legislation and transposes the EU's Covered Bonds Directive (EU) 2019/2162. The Covered Bonds Act is the result of an EBRD funded project aimed at creating a modern covered bonds market in Bulgaria and encouraging cross-border investment into and from Bulgaria. In addition, in March 2021 a new law on special purpose and securitisation companies has entered into force, which established a legal framework for securitisations in Bulgaria.

It is yet to be seen what the impact of these modernisation efforts on the wholesale funding of Bulgarian banks will be.

GREEN FUNDING

The National Recovery and Resilience Plan, part of Next Generation EU, envisages the establishment of a National Program for Energy Renovation of Residential and Non-Residential Buildings (the Program) under the auspices of the Ministry of Regional Development and Public Works. The total funds dedicated to the Program are BGN 2.47 bn (EUR 1.26 bn) for the renovation of multifamily residential buildings, public and commercial buildings in the period 2022-2026.

The main goal of the Program is to achieve a 30% increase in energy efficiency in participating buildings through the funding of projects, such as the thermal insulation of buildings, the renovation of common heating, cooling and ventilation systems, and the construction of renewable energy installations. The application period for the first stage of the Program started in December 2022. The National Recovery and Resilience Plan also envisages the co-funding of individual investments to increase the energy efficiency of single family and multifamily buildings, such as the construction of solar energy installations, in a total amount of BGN 240 m (EUR 12 3m) in the period 2022-2025.

	BULGARIA 2021	BULGARIA 2022	EU 27 2022
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	7.6	3.4	3.5
Unemployment Rate (LSF), annual average (%) (1)	5.3	4.3	6.2
HICP inflation (%) (1)	2.8	13.0	9.2
HOUSING MARKET			
Owner occupation rate (%) (1)	84.9	85.0	69.1
Gross Fixed Investment in Housing (annual change)(1)	-11.0	-9.2	1.5
Building Permits (2015=100) (2)	41.0	47.3	125.8
House Price Index - country (2015=100) (2)	135.6	156.2	164.6*
House Price Index - capital (2015=100) (2)	140.3	163.5	163.8*
Nominal house price growth (%) (2)	4.5	15.2	10.6*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	8,086	9,390	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	1,412	1,662	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	n/a	n/a	71.5
Gross residential lending, annual growth (%) (2)	37.4	23.5	-6.5
Typical mortgage rate, annual average (%) (2)	3.3	3.1	3.1

* Please note that this value is the simple average of the available values in 2022.

Sources:

(1) Eurostat

(2) European Mortgage Federation – Hypostat 2023, Statistical Tables.

BULGARIA FACT TABLE

Which entities can issue mortgage loans in your country?

In Bulgaria there are no specialised mortgage banks. Therefore, all licensed commercial banks (credit institutions) can provide mortgage loans. The largest and most active lenders of residential mortgage loans are 'tier 1' banks DSK Bank (DSK), UniCredit Bulbank (UCB), Eurobank Bulgaria (Eurobank), United Bulgarian Bank (UBB), First Investment Bank (FIB), as well as 'tier 2' banks KBC Bank Bulgaria (ex Raiffeisenbank Bulgaria) (KBC BG)*, Central Cooperative Bank (CCB) and Allianz Bank Bulgaria (Allianz).

*In March 2023 KBC BG has merged into UBB following an acquisition of KBC BG by UBB in the course of 2022..

What is the market share of new mortgage issuances between these entities?

From 31.12.2021 to 31.12.2022 the total nominal (principal) value of residential mortgage loans issued by Bulgarian banks has increased by ca. BGN* 2.6 bn from BGN 15.82 bn to BGN 18.37 bn. The 8 most active banks on the Bulgarian residential mortgage loan market account for around 95.4% of this increase – UBB and KBC BG (21.3%), UCB (21.2%), Eurobank (20.2%), DSK (18.4%), FIB (5.4%), CCB (4.7%), Allianz (4.2%).

* EUR 1 = BGN 1.95583

Which entities hold what proportion of outstanding mortgage loans in your country?

As of 31.12.2021 the total nominal (principal) value of residential mortgage loans issued by Bulgarian banks is BGN* 18,37bn. The 8 banks mentioned above form BGN 17.57 bn (ca. 96%) of this amount, of which DSK holds BGN 4.25 bn (ca. 23.2%); UBB and KBC BG – BGN 4.13 bn (ca. 22.5%); UCB – BGN 3.30 bn (ca. 18%), Eurobank – BGN 3.06 bn (ca. 16.6%), FIB – BGN 1.14 bn (ca. 6.2%), CCB – BGN 959 mn (ca. 5.2%), Allianz – BGN 725 mn (ca. 4%).

* EUR 1 = BGN 1.95583

What is the typical LTV ratio on residential mortgage loans in your country?

The average LTV ratio is 80%.

How is the distinction made between loans for residential and non-residential purposes in your country?

The official statistics of the Bulgarian National Bank (BNB) provides information only on residential mortgage loans extended by Bulgarian banks (and Bulgarian branches of foreign banks) – reported at nominal (principal) value before deduction of provisions, without fees and currently accrued interest.

BNB defines "residential" or "housing" loans as loans granted to households for the purpose of investing in dwellings for their own use or for letting out, including for the construction and improvement of dwellings, which can be secured by various types of assets.

What is/are the most common mortgage product(s) in your country?

The most widely used mortgage products in Bulgaria are BGN denominated housing loans with variable rates, which are generally defined in the banks own lending policies. The average size of loans is being cited as BGN 150,000.

Interest rates have been decreasing over the last years. In 2022 the average interest rates on BGN denominated housing loans is 2.54%.

What is the typical/average maturity for a mortgage in your country?

The average maturity of mortgage loans in Bulgaria is around 20 – 25 years with maximum term of any mortgage being 35 years.

What is/are the most common ways to fund mortgage lending in your country?

Funding of mortgage loans is based largely on deposits. Alternative funding sources are uncommon in Bulgaria. There is practically no mortgage bond market in Bulgaria, with last mortgage bond issuance dating back to 2014 and all issues being redeemed since, the latest in September 2019. In March 2022 a new Covered Bonds Act transposing the Covered Bonds Directive (EU) 2162/2019 was adopted by the Bulgarian Parliament. There is yet no market for covered bonds in Bulgaria.

What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?

A variety of taxes and fees are associated with purchasing properties in Bulgaria, most of which vary according to the property's price, but which may also depend on whether the property has land attached, whether it is being bought through an agent (as opposed to directly from the vendor), or whether there are other consultants involved (e.g. lawyer, surveyor or translator).

In particular, a purchaser should be aware of the following related costs: municipal tax (up to 3% of the purchase price depending on municipality involved, no cap); notary expenses for the purchase and for the establishment of a mortgage (each notarisaton costs between BGN 500 and BGN 6000 depending on the price of the property); state fee for registration of the purchase and the mortgage in the Bulgarian Property Register (each registration costs 0.1% of the property price, no cap); potential VAT implications of the purchase must also be considered.

What is the level (if any) of government subsidies for house purchases in your country?

Not available, other than limited tax benefits for young families (spouse not elder than 35 years), which can deduct from their taxable income interest payments on loans (or the part of loans) up to BGN 100,000.