

Bulgaria

By Petar Ivanov, Tsvetkova Bebov Komarevski, member of Eversheds Sutherland

IN A NUTSHELL

- The economy began a steady recovery from the pandemic-induced crisis, which resulted in a GDP increase of 4.2%.
- The conflict in Ukraine and the resulting disruption of energy and raw material supply is expected to dampen the economic recovery in 2022 and has already resulted to a significant rise in inflation.
- The mortgage market continued to grow rapidly throughout 2021 and the first months of 2022, fuelled by record-low interest rates and rising inflation, amid a steady rise in housing prices and a drop in supply.
- Two new acts of legislation aim at improving conditions for the issuance of securitisations and covered bonds.
- The Bulgarian National Recovery and Resilience Plan will create new opportunities for homeowners to improve the energy efficiency of their buildings.

MACROECONOMIC OVERVIEW

The economy recovered from the economic shock caused by the pandemic. The projected GDP increase is 4.2% (to BGN 132,7 bn) compared to 2020, which remains 0.4% below the 2019 GDP level. This compares to an EU average GDP growth rate of 5.4% (5.4% in the Eurozone) and an EU average decrease of 0.8% (1.3% in the Eurozone) compared to 2019.

The recovery was supported mainly by strong private consumption and increased government spending, partly due to government policies targeted at providing public support to economic sectors and individuals affected by the pandemic. Increased government spending resulted in a fiscal deficit of 4.1% (4.0% in 2020 and fiscal surplus of 2% in 2019), which is below the EU average deficit of 4.7% (5.1% deficit in the Eurozone).

Unemployment fell by 0.8% to 5.3% in 2021, which is significantly lower than the EU average of 7% (7.7% in the Eurozone). Average wages continued their growth throughout 2021 and increased by 12% compared to 2020 and 21% compared to 2019. Inflation increased from 1.2% in December 2020 to 2.8% in December 2021.

LOOKING AHEAD

The overall favourable economic outlook at the end of 2021 abruptly changed in the first months of 2022 following Russia's invasion of Ukraine in late February 2022 and the imposition of sanctions on and by Russia, which further disrupted raw material and energy supplies across Central and Eastern Europe.

Bulgaria, which relies on imports from Russia for most of its gas and oil needs, was particularly affected by these events and saw a significant rise in energy

and petrol prices, which was intensified after gas supplies from Russia were suspended in the end of April 2022. The conflict in Ukraine also created uncertainty for the construction sector, which traditionally purchases steel and other construction materials from Ukraine and Russia and had to seek alternative suppliers at higher prices.

Accordingly, the European Commission, in its spring economic forecast for Bulgaria, decreased the country's expected GDP growth for 2022 from 3.7% to 2.1% (2.7% in the EU and the Eurozone) and projected a significant increase of inflation to 11.9% (6.8% in the EU and 6.1% in the Eurozone). As of May 2022, inflation stood at 13.4%.

Despite the conflict, in the first quarter of 2022 house prices continued to grow with a year-on-year increase of 11.4%. The rise of inflation coupled with historically low interest rates also pushed the demand for housing loans, the volume of newly issued housing loans continued to increase year-on-year in the first five months of 2022. Interest rates on housing loans in BGN decreased to a historic low of 2.54% in May 2022, while interest rates on EUR denominated loans slightly increased compared to the first months of 2022 to 3.10%.

It remains to be seen whether the momentum of the Bulgarian mortgage and housing market will be dampened by the deteriorating macroeconomic conditions, rising uncertainty, and the likely further increase of home prices as 2022 progresses.

HOUSING MARKETS

2021 was a year of post-COVID recovery for the Bulgarian housing market. The year saw a significant increase in activity with 7,047 issued building permits (5,860 in 2020) the largest number of new building permits issued in Bulgaria since 2008 (10,157). Housing starts also increased to 5,084 in 2021 compared to 4,116 in the previous year. The gradual weakening of anti-pandemic measures supported a further increase in the completion rate of new residential buildings from 3,376 in 2020 to 3,898. These developments contributed to a 37% increase in the volume of new gross residential lending from BGN 3.9bn (ca. EUR 2bn) in 2020 to BGN 5.4bn (ca. EUR 2.8bn).

Against this background average house price levels increased by 8.7% y-o-y to a 2021 average of 149.3 (2015 = 100). The housing market continues to show regional differences, with the South-east having roughly 30% lower average price increases than the country wide increase, which is likely a result of the cooling down of the very active housing market on Bulgaria's southern Black Sea coast before and around 2015. At the opposite end is the capital – Sofia, where the HPI is nearly 13% higher than the national average and increased from an average for the year of 152.17 (2015=100) in 2020 to 168.27 in 2021. Similar trends are also observed in Plovdiv – Bulgaria's second city (nearly 8% growth y-o-y to an average of 160 in 2021) with a more moderate growth around the country average in the other largest cities. These discrepancies are explained by the fact that the larger cities (and their suburban metropolitan areas) continue to be the most desired places to live.

The main driver of rising prices is the ever-growing demand for housing, which has resulted in a tightening on the supply side of the market. Other factors, such as the higher average wages in large cities – for instance, the average wage in Sofia was 36% higher than the nation-wide average for 2021 – also contribute to differing price increases.

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

MORTGAGE MARKET

MARKET DYNAMICS

The mortgage market has had a decade of sustained growth in lending volumes and lowering of interest rates on residential mortgage loans. This process started in 2010 with a slow recovery following its crash from 2008/2009 as a result of the global economic crisis of 2008.

2021 marked the peak of this growth period as the market grew by 15% to a total outstanding amount of residential mortgage loans of BGN 15.8 bn (ca. EUR 8.1 bn). The amount of new gross mortgage lending has grown with an even higher pace – 37% compared with 2020. Interest rates on mortgage loans followed the trend from the preceding years and decreased to an annual average of 2.71% for BGN denominated loans (2.88% in 2020) and 3.27% for loans in EUR (3.52% in 2020). Although these figures remain above the EU average, they are well below the levels reached on the Bulgarian mortgage market a decade ago in 2009 (10.09% for loans in BGN and 8.59% for loans in EUR).

Floating interest rates remain the most popular for new loans (nearly 98%), with the large majority of loans being BGN denominated (91% of all outstanding loans and 96% of new loans) despite the country's declared goal of joining the Eurozone in 2024. The maximum maturity term for new mortgage loans in the country is 35 years with an average of 20 – 25 years. The typical amount borrowed on new loans ranges between BGN 100,000 – BGN 140,000 (ca. EUR 51,000 – EUR 71,600) with an LTV of 70% - 80%, which is comparable with pre-COVID figures.

The increased demand for housing loans in 2021 can be attributed to the favourable market conditions – low interest rates and higher inflation – and the desire to convert savings into a housing investment, which is perceived by domestic borrowers as more secure amid concerns over the post-pandemic economic recovery.

Housing NPL levels continued to decrease in 2021 to 3.6% (BGN 573m) of all outstanding mortgage loans (5.5% (BGN 727m) in 2020).

On the supply side, credit standards for households for house purchases in 2021 remained relatively relaxed with view of the overall positive macroeconomic outlook at the end of the year.

NON-MARKET LED INITIATIVES AND FURTHER IMPORTANT EVOLUTION

The gradual phasing out of most anti-pandemic measures in 2021 resulted in robust growth of the domestic mortgage market. With most of the economy fully reopened for business, average wages increasing and interest rates consistently falling, prospective homeowners were encouraged to enter the mortgage loan market.

The potential adverse effects of the pandemic on existing borrowers has been successfully held back by the private moratorium on loan repayments initiated by the Association of Banks in Bulgaria (the sectorial body of the local banking sector) under the auspices of the Bulgarian National Bank, which allows borrowers affected by the economic fallout of the pandemic to reschedule loan repayments for a period of up to 9 months. This moratorium scheme follows guidelines on the capital treatment of payments moratoria issued by the European Banking Authority in April 2020 and is aimed at preventing the large-scale requalification of credit exposures from performing to non-performing as a result of the short-term effects of the pandemic. As of December 2021, when the scheme expired, loans extended to Bulgarian households (incl. consumer and mortgage loans) in the gross amount of BGN 1.77bn (ca. EUR 905m) have successfully been included in the scheme. Following the moratorium's expiry the NPL levels continued to decrease.

MORTGAGE FUNDING

Bank funding in Bulgaria is dominated by deposits. As at the end of 2020, the Bulgarian banking sector has accumulated BGN 115bn (ca. EUR 59 bn) in deposits (2020 – BGN 105.7 bn), which compares to 87% of Bulgaria's projected 2021 GDP and 85% of the banking system's assets. Household deposits account for BGN 68.1 bn (EUR 34.8 bn) or 59% of the total amount, followed by deposits of non-financial entities – BGN 34.4 bn (EUR 17.6 bn) or 30%, and deposits of financial entities – BGN 9.9 bn (EUR 5 bn) or 8.6%.

This dominance of deposit funding is mainly due to the well-established preference of households and non-financial entities to invest their funds in bank deposits but is also probably a consequence of the underdevelopment of the Bulgarian capital market. The growth in deposits is also a result of the improvement of the macroeconomic environment and 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 product 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, 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 Bulgarian 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 Bulgarian Ministry of Regional Development and Public Works. The total funds dedicated to the Program amount to 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 of 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 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 mn (EUR 123 mn) in the period 2022 - 2025.

	BULGARIA 2020	BULGARIA 2021	EU 27 2021
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-4.4	4.2	5.4
Unemployment Rate (LSF), annual average (%) (1)	5.1	5.3	7.0
HICP inflation (%) (1)	1.2	2.8	3.0
HOUSING MARKET			
Owner occupation rate (%) (1)	84.3	84.9	70.0
Gross Fixed Investment in Housing (annual change)(1)	0.7	-11.0	6.6
Building Permits (2015=100) (2)	33.9	41.0	134.0
House Price Index – country (2015=100) (2)	129.7	135.6	145.2*
House Price Index – capital (2015=100) (2)	133.6	140.3	146.1*
Nominal house price growth (%) (2)	0.9	4.5	10.3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	7,031	8,086	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	1,220	1,412	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	n/a	n/a	62.8*
Gross residential lending, annual growth (%) (2)	12.3	37.4	12.2
Typical mortgage rate, annual average (%) (2)	3.5	3.3	2.0

* Please note that this value is the simple average of the available values in 2021.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hyostat 2022, 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 Raiffeisenbank Bulgaria (RBB)*, Central Cooperative Bank (CCB) and Allianz Bank Bulgaria (Allianz).

*RBB is in the process of being acquired by UBB.

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

From 31.12.2020 to 31.12.2021 the total nominal (principal) value of residential mortgage loans issued by Bulgarian banks has increased by BGN* 2.06 bn from BGN 13.75 bn to BGN 15.81 bn. The 8 most active banks on the Bulgarian residential mortgage loan market account for around 92.87% of this increase – UCB (18.9%), DSK (17.91%), Eurobank (14.5%), RBB (14%), CCB (9.88%), UBB (7.64%), Allianz (5.7%), FIB (4.33%).

* 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* 15,81bn. The 8 banks mentioned above form BGN 15.13 bn (ca. 95.7%) of this amount, of which DSK holds BGN 3.78 bn (ca. 23.92%), UCB – BGN 2.76 bn (ca. 17.46%), Eurobank – BGN 2.54 bn (ca. 16.06%), RBB – BGN 1.86 bn (ca. 11.74%), UBB – BGN 1.73 bn (ca. 10.92%), FIB – BGN 1 bn (ca. 6.7%), CCB – BGN 841 mn (ca. 5.32%), Allianz – BGN 618 mn (ca. 3.91%).

* EUR 1 = BGN 1.95583

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

The average LTV ratio is 70% - 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 between BGN 100,000 and BGN 140,000, with BGN 120,000 being cited as market average for 2021.

Interest rates have been decreasing over the last years. In December 2021 the average interest rates on BGN denominated housing loans is 2.62%.

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.

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 notarisation 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.