The Icelandic housing market: on the road to stability ?

↳ By Sveinn Agnarsson

1. Introduction

Since 2000, the Iceland housing market has been characterized by large price fluctuations and stop-go cycles on the supply side. These developments have caused considerable uncertainty, not least among low-income groups. These chronic imbalances have led the authorities to implement various policies aimed at improving the institutional framework in the market, simplifying governance and administration, and improving the position of the most vulnerable groups in the housing market. In this paper we analyse the most relevant government actions undertaken and discuss the main trends since 2010.

2. Policy developments following the Great Recession

Following the Great Recession in 2008, GDP in Iceland fell by 7.7% in 2009 and a further 2.8% in 2010, before stabilising over the next two years. The crisis led to a rapid depreciation of the Icelandic krona, which fell in value by half against the US dollar and Euro in the period January 2008 to July 2009. As a consequence, inflation increased rapidly with the annual rate peaking at 18.6% in January 2009, before subsiding again to around 2% in early 2014, slightly below the Central Bank‘s 2.5% inflation target. Although house prices also rose, the rise of the general price level eroded real housing prices which declined by a third from January 2008 to May 2011.

As noted in Agnarsson (2015), the depreciation of the krona and rising price level had disastrous consequences for homeowners as nearly all mortgages were either indexed to the CPI or linked to foreign currencies, while nominal mortgages that constitute the norm in other countries were rare. In the years that followed, the legality of the CPI- and foreign currency linked was questioned with the Supreme Court finally ruling in June 2010, that it was illegal to index payments denominated in Icelandic krona to changes in currency exchange rate.[1] Consequently, the loans were recalculated as if they had been issued in krona. In effect, this amounted to a large write down of all foreign currency linked mortgages. CPI-indexed loans and loans denominated in foreign currency were also contested in courts but deemed lawful. According to a study undertaken by the Central Bank of Iceland, at the end of 2008, close to 90% of all mortgagors (76,000 households) held ISK-denominated mortgages, 2.5% (2,100 households) had foreign-denominated mortgages only, while 7.7% (6,500 households) had a mix of ISK- and foreign-denominated mortgages.[2]

The centre-right coalition Government that came into power in May 2013 presented a 10-point action plan aimed at addressing the debt problems of households and ensuring stability and transparency in the mortgage market of the future.[3] The major part of the measures, which were collectively known as the Correction (*Leiðréttingin*), consisted of an across-the-board write-down of the loan principal of CPI-indexed mortgages, but the plight of those holding mortgages denominated in foreign currency was also addressed. According to a report by the Minister of Finance and Economic Affairs presented to Alþingi, the Icelandic parliament, in 2017, the write-downs totalled ISK 71 billion (€ 460 million). High income groups received most of the write-downs, with 30% accruing to the 10% with the highest income, while the lower income half received 14% of the write-downs.[4] Households were also allowed to use private pension payments (third pillar pensions) to either pay down their housing mortgages or towards buying a home. Income-tax payments were completely waived on these withdrawals. These measures came into effect in 2014 and were originally only intended to hold for three years but have since been extended. Since 2014, a total of 62,400 individuals have taken advantage of these measures, with the withdrawals totalling ISK 93.4 billion (€ 600 million). The associated tax savings of individuals – and corresponding drop in government income – have been estimated at ISK 27 billion (€ 170 million).[5] Most individuals with a private pension plan have above-average earnings[6] and the withdrawals will therefore probably not have much impact on the pension provision of low-income groups. However, lower future tax revenue will reduce the ability of governments to maintain the social welfare system. The impact on the future income of those taking advantage of these measures will probably be minimal as the annual withdrawals were limited to ISK 500,000 (€ 3,200) for individuals and ISK 750,000 (€ 4,800) for couples for up to 3 years.

The action plan also called for the establishment of a special working group that was charged with the task of presenting recommendations for a new state housing policy. ESA, the EFTA Surveillance Authority, had earlier ruled that the scope of the state-owned Housing Financing Fund (HFF, *Íbúðalánasjóður*) public service activities needed to be more clearly defined in order to ensure that various

[1] Supreme Court ruling 153/2010. Available at: http://haestirettur.is/domar?nr=6714&leit=t.

[2] Ólafsson, T.T., and Vignisdóttir, K.A. (2012). Households' position in the financial crisis in Iceland. Central Bank of Iceland Working Papers no 59. Available at: https://www.cb.is/library/Skraarsafn---EN/Working-Papers/Working_Paper_59.pdf

[3] Parlimanetary resolution 9/2013. Available at: www.althingi.is/altext/142/s/0009.html

[4] Skýrsla fjármála- og efnahagsráðherra um niðurfærslu verðtryggðra fasteignalána. Available at: https://www.stjornarradid.is/media/fjarmalaraduneyti-media/media/frettatengt2016/2017-01-18-skyrsla-um-hofudstolslaekkun.pdf

[5] Sprenging í nýtingu á séreignarsparnaði til að borga niður húsnæðislán skattfrjálst. Kjarninn February 3. 2022. Available at: https://kjarninn.is/skyring/sprenging-i-nytingu-a-sereignarsparnadi-til-ad-borga-nidur-husnaedislan-skattfrjalst/

[6] Höfuðstólslækkun húsnæðislána (2013). Forsætisráðuneytið. Available at: https://www.stjornarradid.is/media/forsaetisraduneyti-media/media/skyrslur/hofudstolslaekkun-husnaedislana.pdf

state aid measures offered by HFF were limited to the public service activities of HFF and did not concern other commercial activities outside the scope of the public service.[7]

In the ensuing years, several changes were made to HFF, culminating in 2020 when the Fund was amalgamated with the Iceland Construction Authority to form the Housing and Construction Authority (*Húsnæðis- og mannvirkjastofnun*, HMS). The agency is responsible for administration of matters related to housing, construction and electricity security, as well as construction supplies and fire prevention. HMS shall further seek ways to establish stability in the housing market, through housing benefits, provision of loans, research, planning and information dissemination and supervision. The housing measures are intended to assist low-income and disadvantaged groups.

HMS handles the general administration of housing benefits which are intended to assist those who live in social housing, student residences or rent in the open market. The agency also carries out an annual survey among tenants.

Although the Government is not directly involved in wage negotiations in the private labour market, government policies and initiatives often play a key role in bringing about a successful conclusion. The government contributions typically include changes in tax or welfare policy, including housing. In conjunction with general wage agreements concluded in 2015, the government established the following year a new housing alternative, called Common Apartments (*almenna íbúðakerfið*).[8] The new system partly replaced the state-owned Workers' Dwellings that had been abolished in 2002. At that time the Workers' Dwellings numbered around 7,000 apartments which were either rented out or had been sold at favourable rates, while rental properties owned by municipalities (council housing) and non-profit housing associations amounted to some 4,000 apartments.[9] By comparison, the number of dwellings in Iceland in 2005 totalled 120,000 dwellings, including both apartments in multi-family houses and single-family houses.

The Common Apartment system is based on the Danish Almene Boliger and is funded both by HMS and local communities. Since the system was established in 2016 it has provided funding for construction or purchases of 3,000 apartments in all parts of the country. Of these, just over 1,100 are now rented out. The number of dwellings in Iceland totalled 155,000 in 2022, so that the Common Apartment system includes almost 2% of the apartment stock. The Common Apartments are primarily intended for those below certain income and wealth thresholds, including youth and pensioners, people with disabilities and those who are not able to provide for themselves due to difficult social conditions or financial difficulties. All the housing firms established within the Common Apartments system are non-profit self-owned associations.

In keeping with the ESA ruling, lending by the HMS has been curtailed, and mortgages provided are currently capped at ISK 44 million (€ 315,000), have a maximum lifetime of 40 years, and can either be CPI-indexed or not. All loans are annuities. Special provisions apply to mortgages in communities outside the capital region where the real estate market is thin, and the market value of houses is often much lower than construction cost.

One of the main administrative duties of HMS is to aid and assist communities with their housing planning and maintain a data bank of all approved and implemented plans. The plans are intended to give detailed information on the status of the housing market in each community, analyse supply and demand for different housing options and assess how household need for different alternatives will be met in the next four years.[10] All communities are required to annually update their plans.

In April 2019, the Icelandic government introduced 44 measures aimed at improving the functioning of the housing market. The measures were put forward to facilitate the ongoing labour negotiations and formed into an action plan called Housing for everyone (*Húsnæði fyrir alla*).[11] HMS was charged with overseeing the implementation of 40 out of the 44 measures, with the Ministry of environment and natural resources taking charge of the other four measures. Seven of the measures were related to the Common Apartments program, with governments at both national and community level committing to increased funding and a greater variety of housing options, in order to increase the flexibility and supply of social dwellings. Two of the measures were intended to strengthen the position of non-profit housing self-owned associations, and another six to improve the positions of tenants. Seven of the measures relate to increased cooperation among stakeholders, better access to information, simplification and improvements of the legal framework and construction regulations, and improved use of digital administration.

The action plan also introduced new types of loans, equity-loans, for low-income first-time buyers and those that have not owned property in the last five years. The loans can cover up to 20% of the price of a new apartment, but to qualify, the apartments must be within certain size limits and be vetted by HMS. The loans are granted for 10 years, but the loan period can be extended to up to 25 years. In essence, HMS owns 20% of the apartment. The mortgage carries no interest, and no payments are made until the apartment is sold or the loan has matured, at which point HMS receives its 20% share, which can, depending on how the market has been developed, be higher or lower than the original loan granted.

To date, 26 of the 40 measures have been implemented, another 12 are in process, work on one measure has not started while one measure will not be put into practice.

In 2019, the Government of Iceland asked the OECD to carry out an independent competition assessment of the country's construction and tourism sectors. The assessment, conducted in co-operation with the Icelandic Competition Authority, involved screening the legislation in both sectors using the OECD's Competition Assessment Toolkit. The assessment showed that Iceland has numerous opportunities to encourage competition and reduce administrative burdens in both sectors. In the construction sector, the assessment made 316 detailed recommendations on planning and land use, building regulations, building materials, and regulated professions.[12] Although the outcome of the assessment was not known when the action plan Housing for everyone was

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7 Decision No. 247/11/COL. Available at: http://www.eftasurv.int/media/decisions/247-11-COL.pdf

8 Lws nr. 52/2016. Available at https://www.althingi.is/lagas/152a/2016052.html

9 Sveinsson, J.R. (2020). Assisted housing in Iceland before and after the crash of 2008. In Tunström, M. (ed.), Building affordable homes. Challenges and solutions in the Nordic Regin. Nordregio report 2020:2. Available at: https://www.diva-portal.org/smash/get/diva2:1420468/FULLTEXT01.pdf.#page=47

10 Law nr. 65/2018. Availalbe at: www.althingi.is/lagas/152a/2018.065.html

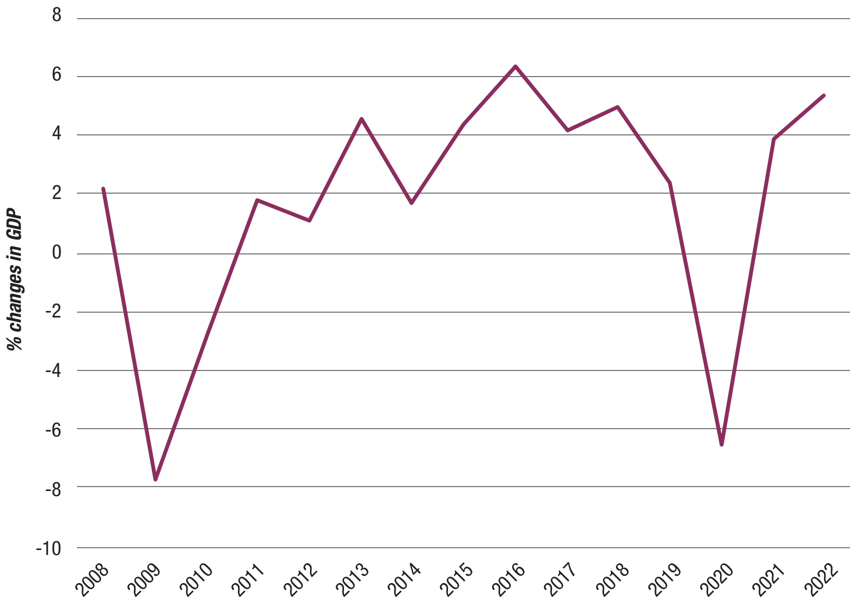
11 See: https://hms.is/husnaedismal/husnaedi-fyrir-alla/

12 Available at: https://www.oecd.org/competition/oecd-competition-assessment-reviews-iceland.htm

initiated, many of the recommendations put forward by OECD are very much in line with the measures included therein.

As noted above, some of the measures that came into effect in 2014, have been extended. This includes the general permission to use private pension payments for the purchase of residential property of own use, or allocation towards a mortgage taken for that purpose. The measures are now set to run out in mid-2023. In 2017, a special provision was made for first-time buyers, who were permitted to use pension payments towards either buying or building their first property, or service a mortgage they had already taken. The measure applies to additional pension savings paid since July 1st 2017 (in some cases even from July 1st 2014), and cover a period of 10 years.

FIGURE 1 Changes in GDP from the previous year



Source: Statistics Iceland

3. COVID-19 measures

The Icelandic economy bounced strongly back in 2013-2019, driven primarily by a tremendous increase in the number foreign tourists that grew from 800 thousand in 2013 to 2.3 million in 2019. Economic growth averaged 4.1% in this period, but like most other economies Iceland was hit hard by the Covid-19 pandemic which resulted in a 6.5% drop in GDP in 2020. However, preliminary figures indicate that growth in 2021 will be 3.9% and is projected to be very strong in 2022, or 5.3%.

Like governments elsewhere, the Icelandic Government introduced various measures aimed at softening the economic impact of COVID-19. During the two years the pandemic raged, various temporary restrictions were imposed on gatherings, personal services, opening hours of restaurants, and schools, as well as border controls. However, widespread lockdowns were never implemented, with shops and elementary schools always remaining open. However, some restrictions were imposed on secondary and tertiary institutes of learning where remote learning became more widespread.

Nevertheless, the restrictions introduced and the huge drop in global tourism had serious effects on the Icelandic economy. The Government therefore adopted a support programme to avoid a meltdown of business and household income. The programme first focused on immediate financial support to households and firms and the health care system and then gradually shifted towards encouraging public and private investment to support the recovery and long-term growth.[13]

The key fiscal policy measures implemented included a temporary increase in unemployment benefits, closure subsidies to small operators, hiring grants, payment of wage costs during the notice period and for time employees spent in quarantine.[14] Businesses whose revenues fell by more than 40% received financial relief, with the severely hit tourism and aviation industry getting special help. A special child benefit supplement was also paid out, government contributions to research and science were increased, and the Government embarked on a five-year investment programme focusing on infrastructure, research and development of around 0.5% of GDP annually. An international marketing campaign to promote Iceland as a tourist destination was also initiated and all individuals legally domiciled in Iceland received a travel gift of ISK 5,000 (€ 35). Additional funds were also provided for public healthcare and civil security.

On the revenue side, a special tax on banks was temporarily reduced, overnight tourist taxes suspended, VAT refund increased for residential or recreational housing, car repairs and for charity organizations, social security contributions reduced, green investment incentives introduced, households allowed to draw on their third-pillar pension savings, and rules on debt restructuring of firms simplified.

The discretionary fiscal measures amounted to around 9% of GDP in 2020, with the automatic stabilisers contributing an additional 8%.

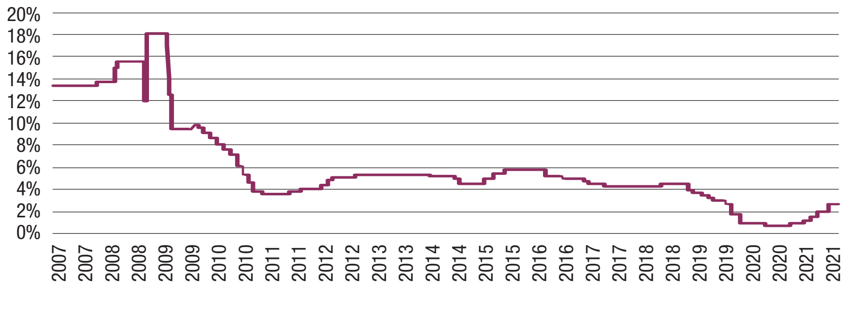
In tandem with the fiscal measures, monetary policy was relaxed and has remained accommodative. Interest rates have traditionally been much higher in Iceland than in almost all other OECD countries, but the Central Bank's key interest rate had fallen to 2.75% at the onset of the pandemic. During the period January 2010 to December 2019 the interest rate averaged 4.9%. Following the outbreak of COVID-19, the interest key rate was in two steps brought in down to 0.75% in November 2020. The Central Bank began to move the interest rate up again in March 2021 and in February 2022 it reached the pre-pandemic rate of 2.75%. The Central Bank has also taken measures to inject liquidity in the financial system, initiated purchases of Treasury bonds on the secondary market, and intervened in the spot foreign exchange market to mitigate exchange rate volatility.[15]

[13] See https://www.oecd-ilibrary.org/sites/88189d26-en/index.html?itemId=/content/component/88189d26-en

[14] See https://www.government.is/government/covid-19/

[15] The Central Bank of Iceland's pandemic response measures. Available at: https://www.cb.is/publications/covid-19-related-notifications/

FIGURE 2 Key interest rate of the Central Bank of Iceland 2007-2022

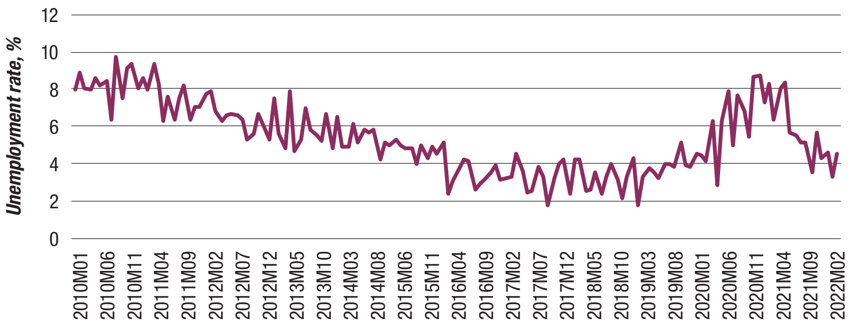


Source: Central Bank of Iceland

FIGURE 3 Annual rate of inflation 2008-2022

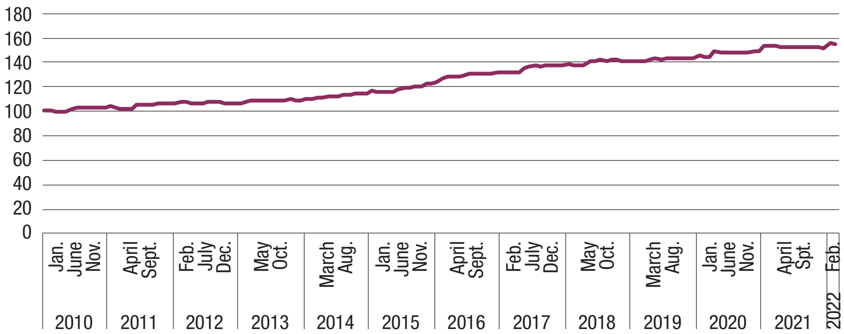
Source: Statistics Iceland

FIGURE 4 Unemployment rate 2010-2022



Source: Statistics Iceland

FIGURE 5 Development of real wages 2010-2022. Index, January 2010=100



Source: Statistics Iceland

Inflation was around the 2.5% target before the onset of COVID-19 but has since risen and measured 6.7% in March 2022. The increase has mainly been driven by sharply increasing global commodity prices and shipping costs, while domestic inflationary pressures have increased as well, with surging house prices leading the way.

After rising in 2021, unemployment has fallen again and was down to 4.5% in February 2022, almost a whole percentage point below the 2010-2021 average.

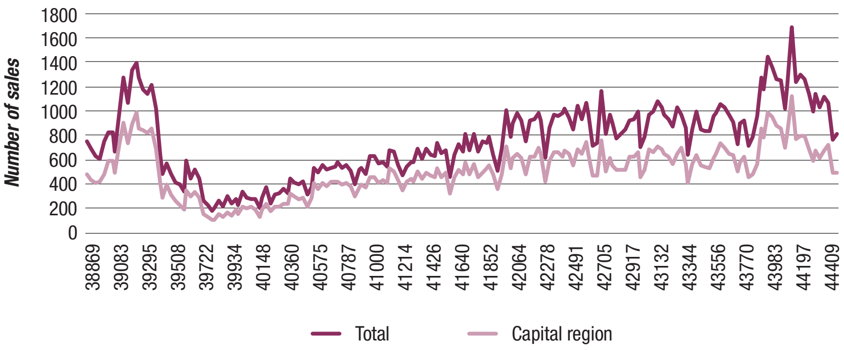
Since June 2010, purchasing power, as measured by the Statistics Iceland real wage index, has increased continuously and in February 2022 real wages were 55% higher than in January 2010. Despite rising inflation and the decline in economic activity in 2020, this development continued unabated, with purchasing power 6.5% higher in February 2022 than it had been in January 2020.

4. Market developments

In the years preceding the Great Recession, the housing market was operating in overdrive, with the number of sales per month rising rapidly in 2006 and 2007. Total sales of dwellings for all of Iceland peaked in June 2007 at 1,400 sales, with 1,000 of these sales or 71% made in the capital region. The housing market began to contract before the recession set in and by September 2008 the number of transactions in the market had fallen to a little over 500 sales, whereof 340 in the capital region. The market remained dormant for the next year but began to pick up again in 2010 with the recovery continuing into 2015. As shown in Figure 6, the housing market then reached relatively stability with the number of transactions per month hovering between 900 and 1,000 in 2015-2020. Since then, activity in the market has been very brisk although the market has cooled somewhat in the last few months.

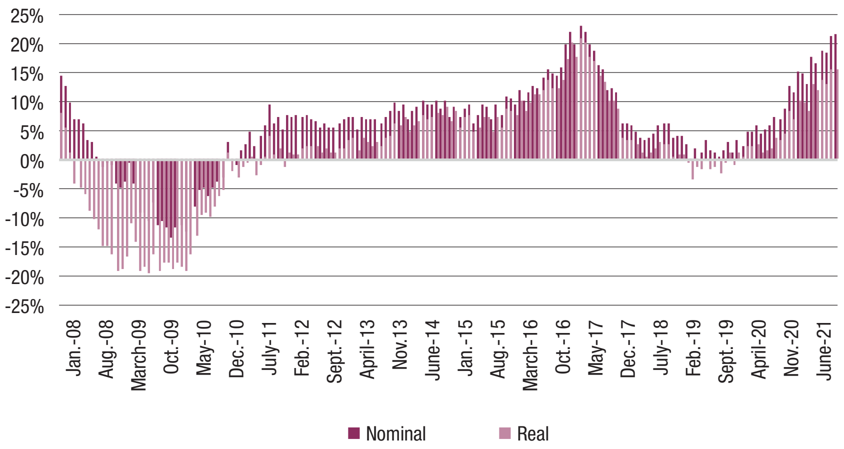
Iceland is essentially a city-state. Around 36% of the country‘s population of 370,000 live in the capital, Reykjavik and 80% of the population live within a 50 km radius of the capital, whereof two thirds in the capital region. As evident from Figure 6, developments in the housing market in the capital area completely dominate the domestic housing market with the number of sales per month in the capital region averaging close to 70% of total transactions in the whole country. In what follows we will therefore primarily focus on the housing market in the capital region.

FIGURE 6 Number of transactions in the whole of Iceland and the capital region 2006-2022. Sales per month



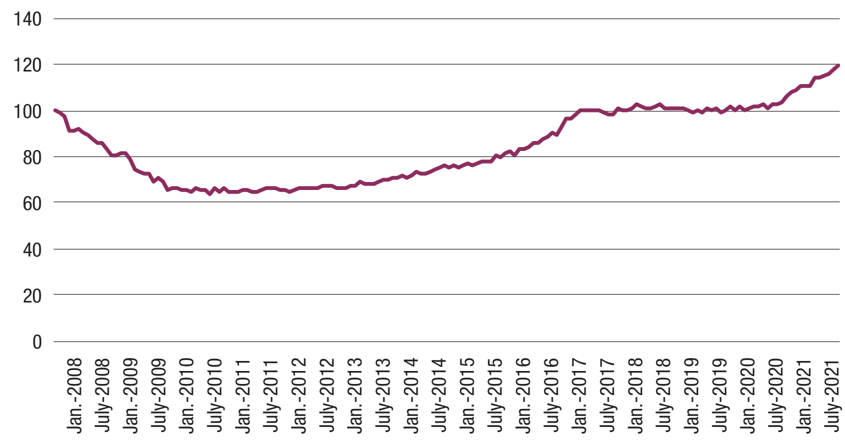
Source: Registers Iceland

FIGURE 7 Monthly year-on-year changes of housing prices in the capital region 2008-2021



Source: Registers Iceland

FIGURE 8 Development of real housing prices in the capital region January 2008-December 2021. Index, January 2008=100



Source: HMS

Real prices in the capital region housing market, as measured by the HMS Case-Shiller House Price Index, began a year-on-year decline in the spring of 2008, with the decline peaking three times; first in early 2009, then again in the latter half of that year and the third time in the spring of 2010. By early 2011 real prices had more or less stabilised, but in February 2012 prices began an uninterrupted increase that lasted until March 2019. During this period, real house prices in the capital region increased by 55% in real terms. Over the next year real prices fell by 1.1%, but then started rising again with the market becoming increasing more buoyant and from February 2020 to December 2021 real prices in the capital region increased by 20%.

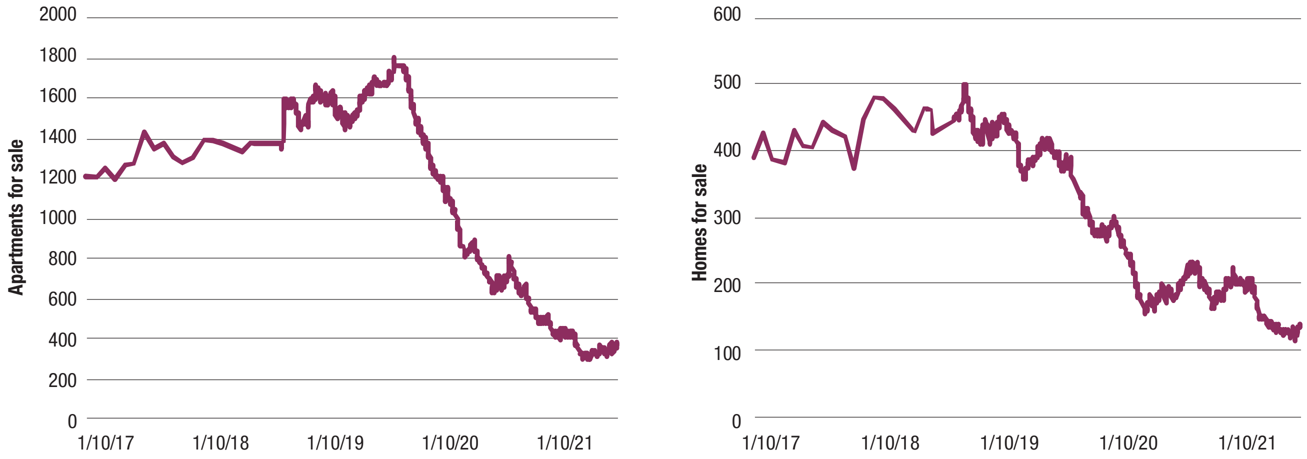
The upward trend in real house prices is brought out better in Figure 8 which traces the development of the Case-Schiller House Price Index over the period 2008-2021. The slow recovery of the market following the Great recession is clearly revealed; it is not until May 2017 that the index reaches the pre-recession level. The figure also clearly reveals the surge in the housing market during the Covid-pandemic.

The situation in the housing market in the capital region can be further clarified by looking at the number of apartments and single-family homes advertised for sale each month since the beginning of 2018. As revealed in Figure 9, the number of dwellings on sale in the capital region has fallen drastically since the autumn of 2020, with the number of apartments in multi-family houses advertised in March 2022 representing only 20% of those on the market in March 2020. The market for single-family homes has similarly become very thin; only 130 homes were on averaged on sales in March 2022 whereas 410 homes had been advertised in March two years earlier. As pointed out by HMS, these figures may even overestimate the number of dwellings for sale as some of them may already be in the process of being sold, and thus not really for sale unless a much-improved offer came along.[16] HMS also notes that in January 2022, 45% of all dwellings for sale in the capital region were sold at a premium on the asking price. Average time-to-sale is also shorter.

Since 2000, around 2,000 new dwellings have been completed each year. Most of these are apartments in multi-family houses but some are single-family

[16] HMS monthly report March 2022. Available at: https://hms.is/media/11620/hms_manadarskyrsla_mars2022.pdf

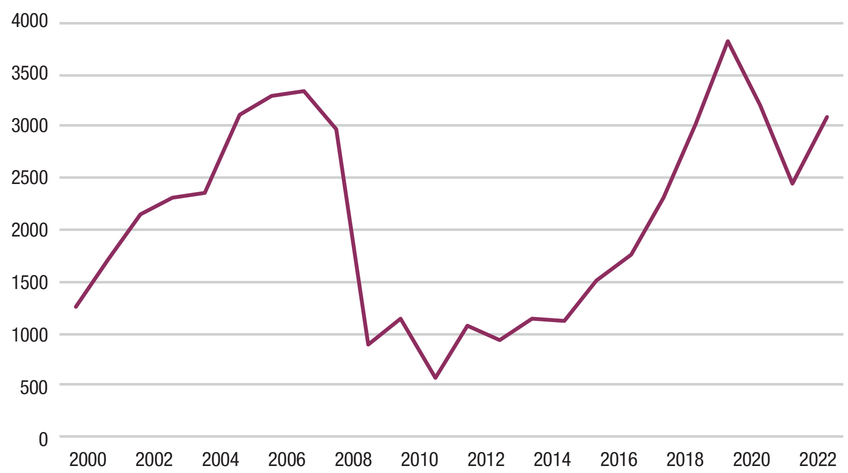
FIGURE 9 Number of apartments in multi-family houses (left panel) and single-family homes (right panel) advertised for sale each month during October 2017-April 2022



Source: HMS

homes. However, as revealed in Figure 9, there have been considerable fluctuations in the number of completed apartments. In the years immediately preceding the Great Recession 3,000-3,350 apartments entered the market each year, but the number dipped to below 1,000 apartments in 2009 and it was not until 2016 that more than 1,500 new apartments came on the market, half of the number in the boom years. The number has since increased with a record number of apartments completed in 2020, or more than 3,800. Recent estimates indicate that around 7,300 dwellings are currently under construction. Of those, 2,500 could be completed in 2022 and 3,100 in 2023. As HMS has estimated the annual need for new housing at 3,500-4,000 dwellings, the number of newly completed apartments is not enough to keep pace with need, let alone address the glut in the housing market that has developed in recent years. In Iceland, planning regulations and development plans establish limits on land use and construction. The process from planning to construction is lengthy and time-consuming and stakeholders have frequently pointed out the need to simplify and streamline the whole. As outlined above, these shortcomings have also been pointed out by OECD and acknowledged in the Housing for everyone action plan.

FIGURE 10 Number of completed apartments each year 2000-2023



Source: HMS and SI[17]

At the turn of the century, around 300,000 tourists visited Iceland each year. By 2007, the number had risen to around 500,000 and the number of tourists stayed around half a million for the next three years. But in 2011, the Icelandic tourism boom really took off, and over the next three years the number of foreigners visiting the country doubled to 1 million in 2014, and more than doubled again in the next three years. In 2017, more than 2.2 million foreign visitors came to Iceland. The number of tourists declined rapidly during the Covid pandemic and in 2021.

To satisfy the need for lodgings, many dwellings were converted to Airbnb apartments and the number of individuals in the capital region offering rooms rose from 1,000 in July 2015 to 2,300 in 2016 and 3,000 in 2018. As the number of tourists declined again, so did the number of individuals renting out Airbnb apartments, and in the summer of 2021 the number of such apartments was down to 1,000. Although it is unclear how many of the dwellings used for Airbnb would otherwise possibly have been for sale, it is quite clear that this development restricted the supply of dwellings on the market, thus contributing to rising prices. Thus, for instance, the direct effects of the growth in Airbnb apartments on the real price of housing has been estimated at about 2% per year during 2014-2017. That corresponds to about 15% of the total rise in real house prices in that period.[18]

[17] https://www.althingi.is/altext/erindi/152/152-1041.pdf

[18] Eliasson, L., and Ragnarsson, O.P. (2018). Short-term renting of residential apartments. Effects of Airbnb in the Icelandic housing market. Central Bank of Iceland, Working paper no. 76. Available at: https://www.cb.is/library/Skraarsafn---EN/Working-Papers/WP%2076.pdf

Factors on the demand side also contributed to rising house prices in 2015-2017. Real wages increased by 5.5% in 2015, 9.5% in 2016 and 5.0% in 2017, while the number of persons residing in the capital area increased by 7% from 2010 to 2017. In addition, the permission to use private pension payments for purchases of residential property or to pay down mortgages has increased the funding opportunities for some house-buyers, above all high-income earners.

Although the rise in house prices in 2020-2022 can also be attributed to shortages on the supply side, demand developments played an even larger part with lower interest rates and Central Bank measures taken to inject liquidity into the financial system fuelling the recent surge in house prices. The measures include lowering the reserve requirement for deposit institutions from 1% to 0% and reducing the countercyclical capital buffer of banks from 2% to 0%. The treatment of the fixed reserve requirement in liquidity rules was also changed so that the reserves could be used in cases of liquidity outflows. The Central Bank also eliminated its offerings of one-month term deposits which had been one of the banks' main avenues for investing in ISK-denominated liquid assets and complying with liquidity requirements. These measures have increased the funds banks have had available for mortgage lending and as the interest on new mortgage loans has developed broadly in line with the Central Bank key rate, the cost of borrowing has subsided, leading to higher prices in the housing market.

As the Covid pandemic limited travel and may also have curbed other spending opportunities, the possibility to invest in housing may have become more attractive. Low interest rates and good speculative profit prospects have doubtlessly helped to make such investment decisions more appealing.

The position of young people in the housing market has in recent years come under strong scrutiny with authorities worried that those individuals have not been able to move away from home and establish their own quarters. When the bill on equity-loans loans was introduced to Parliament, it was noted that the income of young people had not kept pace with the income development of other age groups, while property prices had been rising.[19] The implementation of the Basel III and EU Directive 2013/36/EU (CRD IV) and laws nr. 33/2013 on consumer protection and laws nr 118/2016 on mortgage loans had also made the terms of property lending stricter, which had had a disproportional effect on young people and first-time buyers. As noted above, two kinds of measures have been introduced to help first-time buyers enter the housing market. Since 2017, first-time buyers have been permitted to use pension payments to fund purchases or pay off mortgages, and since 2020 they have also been able to apply for equity-loans. At first, these measures seemed to have a solid impact, with the ratio of first-time buyers rising from 27.1% of all house buyers in the capital region in Q4/2017 to 33.7% in Q1/2021. Since then, the ratio of first-time buyers has fallen slightly and was down to 31.3% in Q1/2022. The equity-loans have not been the success that was hoped, as the provisions for such mortgage loans do not take into the account the rapid price rise in the housing market. As an example, HMS will only sanction equity-loans for a two-bedroom apartment if its size is no less than 70 m2 and price no higher than ISK 51.5 million (€ 370,000). A simple search undertaken on April 14th 2022 revealed that only 7 of the 142 apartments of that size then for sale in the capital region were priced at or below that threshold. However, none of the seven apartments was new and would therefore probably not be vetted by HMS.

Since June 2021, the Financial Stability Committee (FSC) of the Icelandic Central Bank has introduced several measures in order to cool the real estate market and limit rising household debt. The general maximum loan-to-value ratio for consumer mortgages was reduced from 85% to 80% in June 2021, but this reduction did not apply to the 90% level of first-time buyers.[20] In September, the FSC decided to utilise provisions in the Act on Mortgage Lending to Consumer, no 118/2016, to set the maximum debt service-to-income ratio at 40% for first-time buyers, and 35% for all other buyers. The FSC also stated that as rapidly rising asset prices and household debt had raised cyclical system risks, it would be prudent to reverse the reduction in the countercyclical capital buffer of financial institutions to its 2% pre-pandemic level.[21]

5. Outlook and conclusions

Real house prices have continued to rise in 2022, with the Case-Schiller index increasing by 22.3% between March 2021 and March 2022. Demand for housing has remained strong, and with supply limited, this has in many cases led to bidding wars. The demand for apartments in multi-family houses in the capital region has been especially high, as witnessed by the fact that in March 2022, more than 61% of those apartments were sold at a premium above the asking price, and only 24% at prices below the asking price. More than half of single-family homes were also sold at a premium above the asking prices. The average time-to-sales in March 2022 for apartments in the capital region was 36 days and has never been shorter.

A recent report estimates that at least 4,500 apartments are needed to satisfy the current excess demand in the market and around 35,000 new apartments must be completed in the next decade to meet increased demand brought about by demographic changes and population increases. Housing is also needed for seasonal labour, for instance those engaged in tourism, and asylum seekers.[22]

The report also underlines that in order to achieve stability in the housing market, supply must be more in line with demand. To achieve this, three conditions must be met. First, at the local level communities must carry out their housing plans, thus analysing the demand for new housing and putting forward plans to satisfy that demand. Second, a coherent analysis of the need for housing at the national level must be carried out, based on improved population forecasts and local housing plans. Third, up to date and reliable information must exist on the number of apartments in the various stages of construction. The report also underlines the need for the Common Apartments system, pointing out that long-term financing must be secured and allocations to building societies made more predictable and systematic.

While there are hopes that a better balance in the estate market will be achieved in the coming years, the current situation will persist in the short-term. However, it is likely that the price pressure will ease a little in 2022. Although real wages have

[19] See: https://www.althingi.is/altext/150/s/1662.html

[20] Statement of the Financial Stability Committee 30 June 2021. Available at: https://www.cb.is/library/Skraarsafn---EN/Financial_Stability/FSC/FSN_Yfirlysing_30.6.2021_En.pdf

[21] Statement of the Financial Stability Committee 29 September 2021. Available at: https://www.cb.is/library/Skraarsafn---EN/Financial_Stability/FSC/en_Yfirlysing_FSN_29.9.2021.pdf

[22] Niðurstöður starfshóps um aðgerðir og umbætur á húsnæðismarkaði. Available at: https://www.stjornarradid.is/library/01--Frettatengt---myndir-og-skrar/IRN/Frettatengd-skjol/Starfsh%c3%b3pur%20um%20umb%c3%a6tur%20%c3%a1%20h%c3%basn%c3%a6%c3%b0ismarka%c3%b0i%20-%20sk%c3%bdrsla%20-%20lokaeintak.pdf

been increasing, the cost of servicing mortgages has increased with rising interest rates and the recent measures implemented by the Central Bank will cool the market. As life returns to pre-Covid normality, people will start to travel more and revert to their previous consumption patterns, which will reduce savings and the scope for investment in housing. At the same time higher housing prices will make it more difficult for house buyers to fund the 10-20% of the cost not covered by ordinary mortgage loans. Although the future is always difficult to predict, there are two types of uncertainty that may be of special relevance. Most labour agreements in the private market run out in the autumn of 2022, and the outcome of the negotiations – and the possible government initiatives – can impact on the housing market. The international situation is also precarious, with the Russian invasion of Ukraine and the subsequent war, affecting prices and supply in many markets. Although the Icelandic housing market is expected to become more stable, there is therefore a risk that the road towards a better balance will be difficult and long.