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SUMMARY

Corporate assessments of access to funding improved throughout 2021, and by the end of the year they were at their highest level of the past eight years. Companies consider that the willingness of banks and other lenders to lend has improved. The most concerned companies are in accommodation and food service, and in transport, as they have been affected most by the spread of Covid-19 and the related restrictions. Good access to loans and increased demand boosted the growth in lending by banks to companies to around 7% by the end of 2021. The Eesti Pank December forecast 2021 expects corporate indebtedness to grow at around 8% in the coming years.

The highly active real estate sector is the most satisfied with its funding options. The good performance and ability to borrow of real estate companies is also reflected in faster growth in its bank loans at 10% than the growth in other sectors. The share of bank loans in the total funding of real estate businesses has declined though, as the growth in other sources of funding has been even faster. Although the share of funds received from non-bank financial intermediation has increased, the faster growth in non-bank financing is primarily a consequence of companies making greater use than before of inter-company financing. The strong growth in own funds means that the financial leverage of real estate companies has not particularly changed.

Rising incomes and the buffers they have built up are supporting households in their ability and desire to borrow. At the same time the banks have become more active in the housing market. Lending has been extended to more borrowers and the conditions on loans have been eased a little. This overall reflects the rapid growth in lending and also how housing has not become much less affordable or accessible over the past five years despite prices rising fast. Demand for consumption loans has been more modest than previously over the past year. Competition pressures have however started to put some downwards pressure on interest rates, which have so far been very high.

The financial assets of households have increased by around 70%, or more than 18 billion euros, over the past five years because capacity to save has improved and asset prices have risen. Although many people still have few savings, the number of households with financial savings has increased. On top of the rise in incomes, saving has been boosted in the past couple of years by the forced saving during the pandemic and by saving driven by uncertainty. Savings have increased for almost all socio-economic groups, but particularly so for people on higher incomes and for younger people. Although deposits and the second pension pillar continue to dominate among financial assets, the structure of financial investment has become more diverse. There has been growth in the number of people investing in the third pension pillar, exchange-traded securities, crowdfunding, and crypto assets.

The ability of banks in Estonia to lend has remained good and the loan supply has increased. This means that the set of possible borrowers has increased and lending conditions have eased a little. The confidence to lend has been supported by the good performance of the economy, which has seen loan repayment problems for small businesses and households and loan losses at extraordinarily low levels. The capital buffers built up in earlier years, the rapid growth in deposits, and bond issues have helped the banks provide sufficient funding.

Competition increased in 2021 in most segments of the banking market. Several domestic banks have grown strongly and have increased their market share. This was particularly noticeable in the market for long-term corporate loans. The domestic banks increased their share of the housing loan market for households to a lesser extent, but it is still the large foreign-owned banks that dominate there. The market for consumption loans was already more evenly distributed and less concentrated. The result of competition pressures has been that average loan interest rates have fallen a little. Competition should increase in the banking market in future, as several banks are aiming to grow further.

The rapid growth in non-bank financial intermediation through private equity, hedge and investment funds, crowdfunding, savings and loan associations, pension funds, stock markets and so forth has increased the options for finding funding. A bank loan is often not the best option for financing for very small companies or those that are just starting up, as they have no credit history, or insufficient collateral or equity. Non-bank financial intermediation is increasingly helping to fill this gap. Stock markets and funds equally give larger companies ways to use equity capital more simply alongside debt capital. Although non-bank financial intermediation remains modest in Estonia, a record number of businesses funded themselves through non-bank financing in 2021.

1. THE LOAN SUPPLY FROM THE BANKS AND COMPETITION

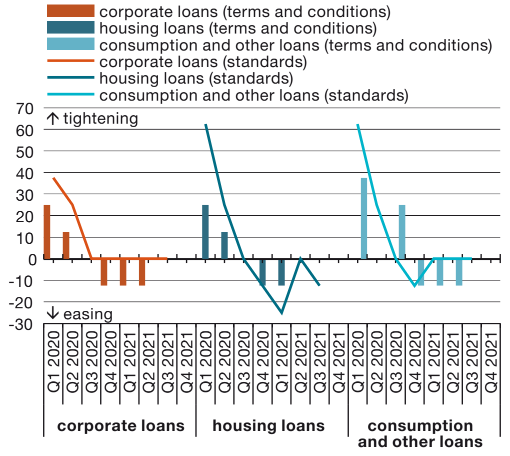
As the Estonian economy has recovered from its crisis, so the loan supply from the banks has started to increase again. The bank lending survey of euro area banks in 2021 showed that unlike in 2020, the banks did not tighten their lending standards any further in 2021 (see Figure 1). There is even evidence in some places of standards being eased, meaning that the number of potential borrowers increased for the banks, and access to loans improved. The banks also told the bank lending survey that the lending conditions under which borrowers could get a loan eased in 2021.

The loan supply increased in 2021 in almost all loan segments. The amount issued in loans increased in almost all loan segments, while the average interest rate fell at the same time, indicating a larger supply of loans in the market (see Table 1). A reduction in supply was only apparent in the segment of short-term corporate bank loans, where the turnover was down over the year and the interest rate was up.

The supply of credit from the banks was affected in 2021 by increased competition pressures. Banks told the bank lending survey that competition pressure on loan margins increased in 2021. A fall in the interest rates on loans was evident in almost all the loan segments (see Figures 2-4[1]).

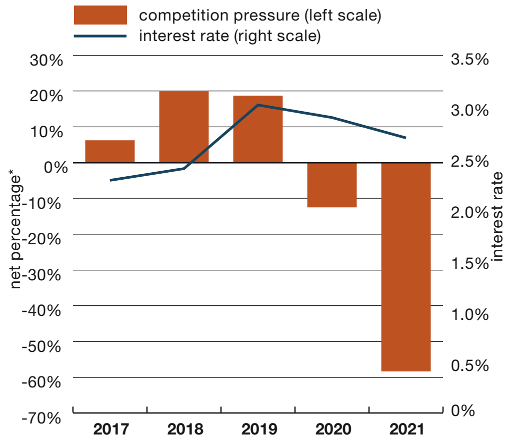
The supply of credit continues to be favoured by the sufficient capitalisation of the

Figure 1. Diffusion index of changes in credit standards, credit terms and conditions



Source: Eesti Pank

Figure 2. Competition pressure on the margins of corporate loans and the interest rate



Sources: European Central Bank, Eesti Pank calculations

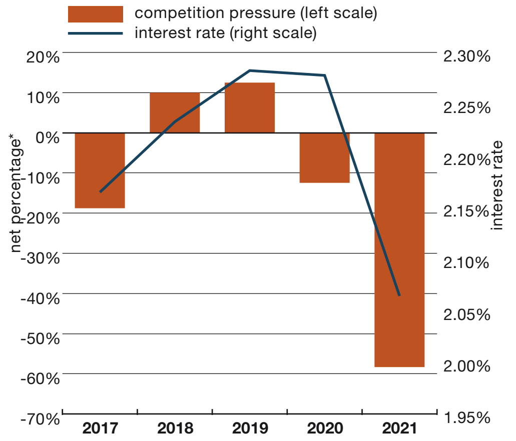
Table 1. Indicators across different loan segments for changes in the loan supply from banks

Loan segment	First 11 months of 2021 over 2020			
	loan contracts		loan turnover	
	interest rate	volume	interest rate	volume
Corporations				
Short-term bank loans	⇧	⇩	⇧	⇩
Long-term corporate bank loans	⇩	⇧	⇩	⇧
Leasing	⇩	⇧	⇩	⇧
Factoring	⇩	⇧	⇩	⇧
Households				
Mortgage loans	⇩	⇧	⇩	⇧
Car leases	⇩	⇧	⇩	⇧
Other household loans	⇩	⇧	⇩	⇧

Explanations:
⇧ increase from the previous year
⇩ decrease from the previous year
possible increase in supply (blue)
possible reduction in supply (orange)

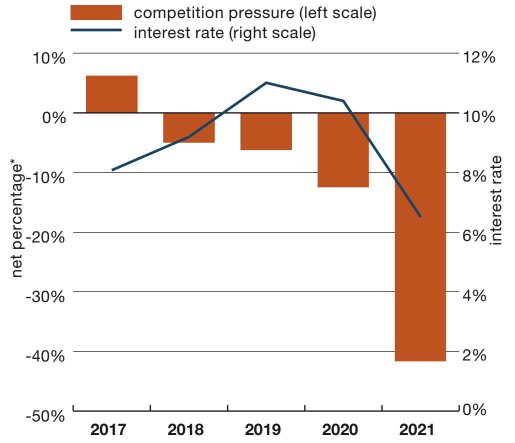
1 *Net percentage is the frequency of banks reporting lower pressure minus frequency of banks reporting higher pressure.

Figure 3. Competition pressure on the margins of housing loans to households and the interest rate



Sources: European Central Bank, Eesti Pank calculations

Figure 4. Competition pressure on the margins of consumption loans to households and the average turnover interest rate



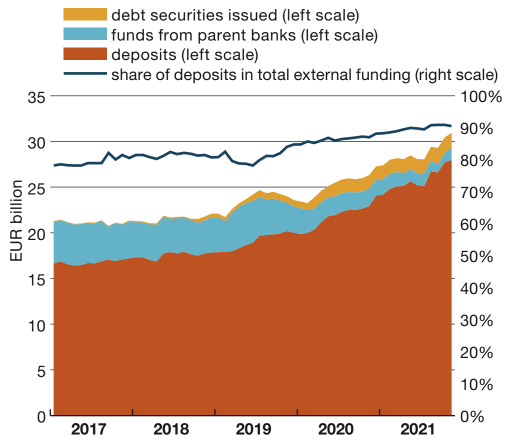
Sources: European Central Bank, Eesti Pank calculations

banks, the rapid growth in deposits, and the low cost of funds. The total own funds of the banking groups consolidated in Estonia covered 26% of their risk exposures as at the end of the third quarter of 2021, which exceeds by a large margin the macroprudential capital requirements. Capitalisation varies somewhat between banking groups however, and rapid growth in assets and possible changes in the future to the capitalisation regulations could cause some banks to need additional capital. Deposits continue to play a very large role in the funding of banks, and they have grown strongly, and faster than the loan portfolio. Deposits provided more than 90% of the funding for the banks at the end of 2021 (see Figure 5). The deposit interest rate paid by the banks has been at historically low levels for a long time now, and so the cost of funding for the banks has remained cheap, and this has benefited the loan supply.

Increased competition pressure is also reflected in the reduced concentration in the Estonian banking sector. The Herfindahl–Hirschman index, which measures concentration, fell for nearly all the loan segments in 2021 (see Figure 6). Concentration increased for other household loans in 2021, because some banks moved their portfolios of consumption loans to subsidiaries outside the banking sector. In reality concentration did not increase.

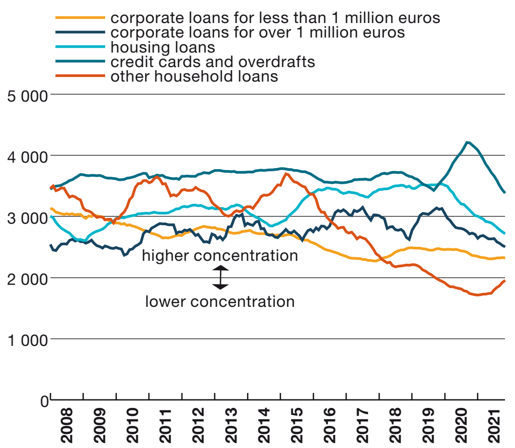
As concentration declined, so the market shares of the banks changed. The changes in the market for long-term corporate loans stood out the most, as domestic banks continued to increase their market share there in 2021 (see

Figure 5. Structure of the debt liabilities of banks



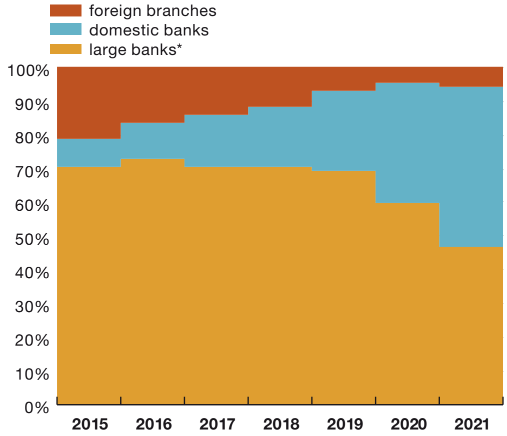
Source: Eesti Pank

Figure 6. Herfindahl–Hirschman Index across different loan segments



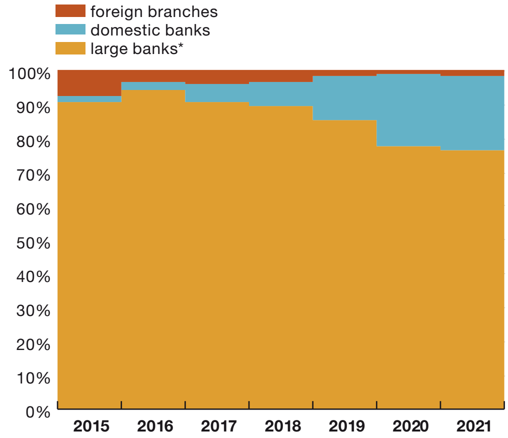
Last observation December 2021
Source: Eesti Pank

Figure 7. Share of the long-term corporate loan market across different groups of banks



* Swedbank, SEB and Luminor
Source: Eesti Pank

Figure 8. Share of the housing loan market across different groups of banks



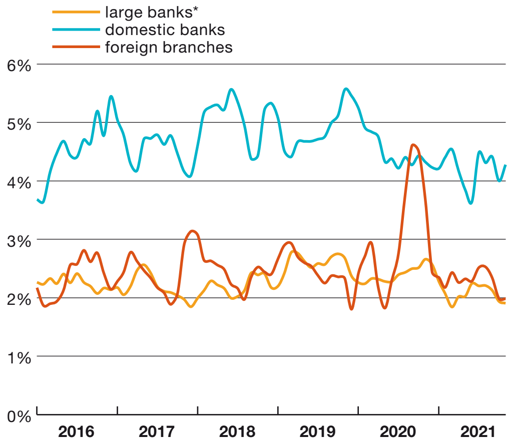
* Swedbank, SEB and Luminor
Source: Eesti Pank

Figure 7). Domestic banks had almost half of the market for long-term corporate bank loans in 2021. They also managed to increase their market share for housing loans to households a little, though this market continues to be dominated by large foreign-owned banks (see Figure 8).

The domestic banks have managed to increase their market share even though the average interest rates on the loans they issue are higher (see Figures 9 and 10). The main reason for this is probably that the clients, loan projects and credit risks of the banks are different. The other conditions on loans are probably more favourable and it is likely that their decision-making process for issuing loans is faster and more flexible.

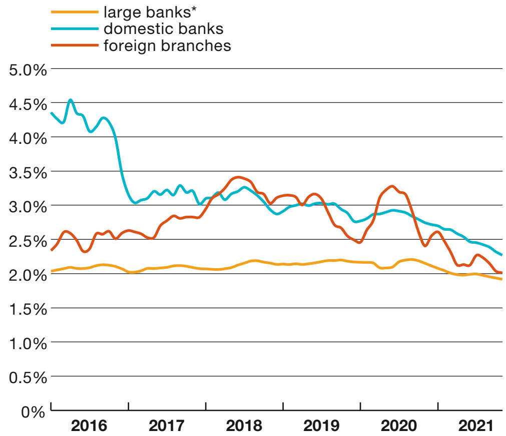
The big banks are able to lend at lower interest rates. This is firstly because they have a large client base that lets them benefit from scale effects, and secondly because they can access funding from their parent banks, which makes their loan capital cheaper. The large banking groups are generally more stable, which means they can access capital more cheaply. They also gain some advantage from the synergy of the banking group, which means that different functions can be distributed across different countries, and they can be more cost efficient and can share skills and knowledge better.

Figure 9. Three-month moving average interest rate on long-term corporate loans



*Swedbank, SEB and Luminor
Source: Eesti Pank

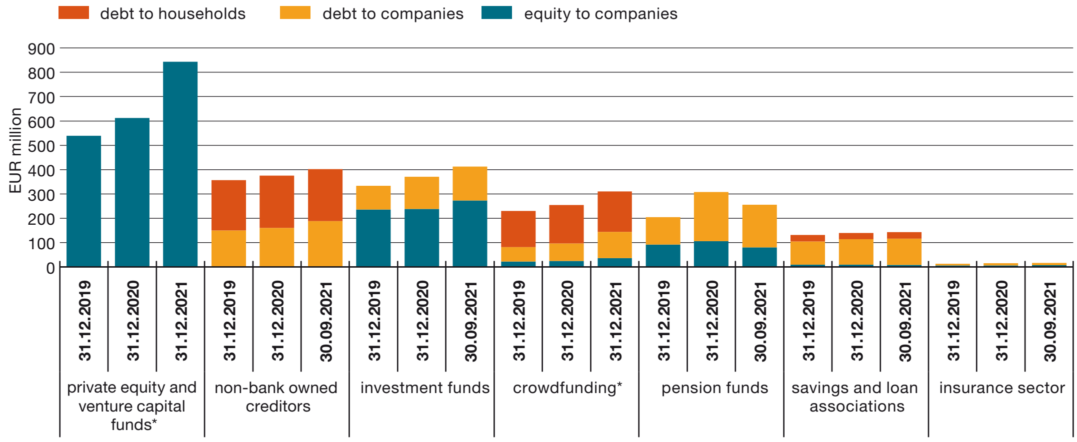
Figure 10. Three-month moving average interest rate on housing loans across different groups of banks



* Swedbank, SEB and Luminor
Source: Eesti Pank

2. THE DEVELOPMENT OF NON-BANK FINANCIAL INTERMEDIATION

Figure 11. The stock of funding intermediated to non-financial companies and households in Estonia by non-bank intermediation



*preliminary and estimated data
Sources: Eesti Pank, EstVCA

Having stood still when the Covid-19 pandemic broke out, a large part of non-bank financial intermediation has started to grow fast again (see Figure 11). Although they play a much more modest role than the banks, other sources of financial intermediation have become more important for funding Estonian companies and households.

FUNDS

Private equity and venture funds hit records in 2021 for the numbers of investments and for the amount of new money received. Preliminary data from the Estonian Private Equity and Venture Capital Association (EstVCA) show that funds made some 150 investments, up from around 100 in 2020. Even though the funds still had some 450 million euros in total of uninvested funds at the start of 2021, they still probably took in record amounts of new money[2]. On average up to half of the money is invested outside Estonia. The funds operating in Estonia invest more than the average in businesses in the early stages of development. Companies in the later growth phase can already get a very large part of their capital from foreign funds.

Direct investment by pension funds in Estonian non-financial companies fell a little in the first three quarters of 2021. Investments were reduced for both equity and bond investments. These investments remain very small as a share of the total volume of pension funds though, at around 5.5%. However, the pension funds affect the Estonian economy most through their funding of the private equity and venture capital sector and of investment funds.

Investment by investment funds increased in companies in the non-financial sector in Estonia. The total value of investment increased by some 50 million euros in the first three quarters of 2021, of which around two thirds came from revaluation of assets. Some two thirds of the investment by investment funds was investment by real estate funds.

CREDITORS INDEPENDENT OF BANKS

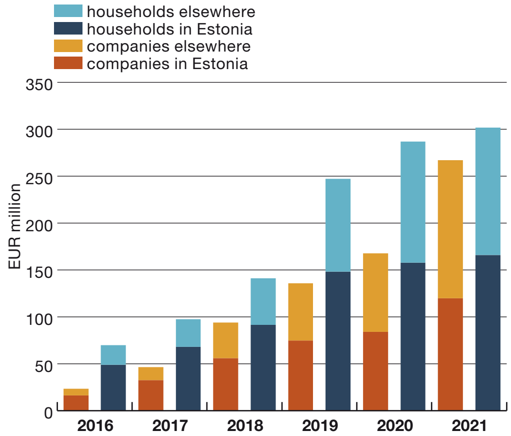
The stock of loans issued by creditors to households remained in 2021 at around where it was a year earlier. It would probably have grown by up to 10%, but the money withdrawn from the second pension pillar was used to repay some 20 million euros of loans. At the same time the stock of funding issued by creditors to non-financial companies increased by some 30 million euros, or around 15%.

CROWDFUNDING

Crowdfunding grew particularly quickly in 2021 for funding given to businesses (see Figure 12). The growth in funding for households was slower than previously. It should be remembered with the rapid growth in Estonian crowdfunding platforms that some of them have expanded their activities strongly into other countries. In consequence the share of funding issued to Estonian companies,

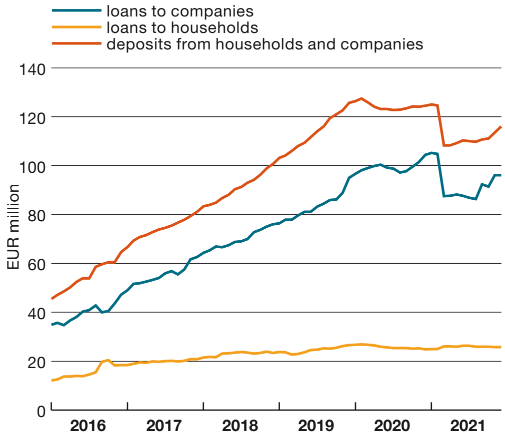
2 There are no precise data yet, but the amount exceeds 600 million euros.

Figure 12. The stock of funding intermediated by crowdfunding platforms*



*estimate
Source: Websites and reports of crowdfunding businesses

Figure 13. Loans and deposits of savings and loan associations



Source: Eesti Pank

and to a smaller extent to households, is steadily declining. This trend towards internationalisation will probably be encouraged further this year by the incoming pan-European regulation.

SAVINGS AND LOAN ASSOCIATIONS

The stock of loans issued to companies by savings and loan associations declined sharply in 2021 as one association ceased its activities. The loan stock started to grow again though in the second half of the year (see Figure 13). The total volume of lending by savings and loan associations to companies and households in Estonia had almost recovered by the end of 2021 back to where it was a year earlier. Lending was supported by a return of growth in deposits. The rate of growth remains slower than it was a couple of years ago though.

Box 1: The role of the stock market in corporate funding

The banking sector has dominated financial intermediation in Estonia so far. The stock market has played a relatively small role as a source of funding, including in the funding for companies[3]. There are several reasons why the stock market has historically not played a large role. Most of the companies operating in Estonia are small, and it is generally cheaper for them to get funding from credit institutions because the fixed costs of entering the capital markets are usually high; households that save are conservative about where they put their money, and prefer to keep their savings in bank deposits; and Europe has historically been more bank-centred in any case.

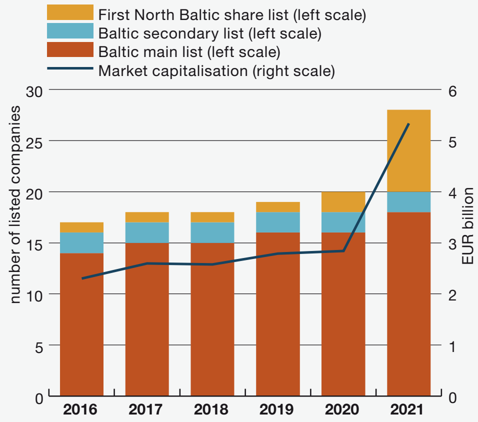
Some signs of revival were apparent in the Estonian stock market in 2021. In the previous five years, hardly any new companies listed on the stock market, but several did so in 2021. The shares of eight companies were listed on the exchange in 2021 and initial public offerings brought in 194 million euros, most of which was the 175 million euros from the listing of Enefit Green. The total capitalisation of the stock market rose by some 90% over the year to stand at 5.3 billion euros at the end of 2021, or 18% of GDP, and the shares of 28 companies were listed on the exchange at the end of December (see Figure 14).

As the firms operating in Estonia are mostly small and the direct and indirect costs of entering the capital markets can be relatively high for them, most of the new listings in 2021 were on the First North alternative market. This is partly because the rules that companies have to follow are simpler there, and partly because the costs are lower. Two companies listed on the main stock exchange list in 2021, while there were six new listings on the First North alternative market.

3 See Financial Sector Structural Review 2021.

The stock market has revived because of both demand-side and supply-side factors. Savings and interest in investment have increased, while some banks eliminated their transaction fees for Baltic shares. On top of this, the money withdrawn from the second pillar pension reform increased demand for shares. At the same time, supply has increased because the initial offerings of shares were oversubscribed several times over, which made companies feel optimistic and encouraged them to list their own shares.

Figure 14. Number of companies listed on the Nasdaq Tallinn Stock Exchange and market capitalisation



Source: Nasdaq Tallinn

Although the stock market still only plays a small role in funding the Estonian economy, its recent revival has helped raise general public awareness of the stock market and of equity funding in Estonia. This is helping to bring savings, which has so far been very concentrated in bank deposits, into investment[4], and is also pushing companies to think more about different ways of raising funding. Although the banking sector dominates financial intermediation in Estonia, and will probably continue to play the main role in funding the economy in future, maximising potential growth in the economy makes it important for different sources of financing, including the stock market, to be diverse and accessible. The revival of the stock market in 2021 might be one sign that sources of funding in Estonia have become more varied and more accessible.

4 See Box 5 The financial assets of households have increased rapidly.

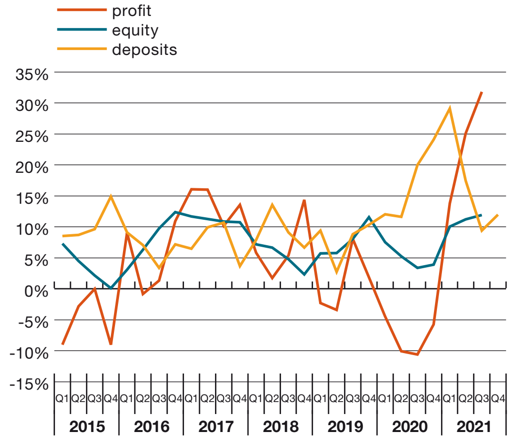
3. ACCESS OF COMPANIES TO FUNDING

The access of companies to funding in 2021 was affected most by the very rapid growth in the economy, the increased competition in the banking market, and the widening of financing options beyond banking. The rapid growth in the economy improved the ability of companies to earn income and to borrow. Some banks continued their aggressive growth strategies, and competition between the banks has increased[5]. The recovery in the economy has probably also reduced the risk assessments of the banks. This can be seen in lending conditions easing a little and loan interest rates falling slightly. Private equity and venture funds, and an active stock exchange and crowdfunding platforms have improved the access of companies to other loans and to equity-based funding[6]. However, the anti-pandemic measures continue to hurt the economic performance of some sectors and their options for funding.

The ability of companies to make investments from their own funds and to purchase assets improved in 2021. This came primarily from the improvement in financial results, as sales revenues and profits grew substantially in most sectors having been low in 2020 (see Figure 15). The liquidity buffers of companies also increased rapidly. This was revealed above all in the growth of around 15% in bank deposits. Corporate equity increased by some 12% over the year, which is more than the growth of around 5% in debt liabilities. Estonian companies stand out in international comparison for their high levels of liquidity and own funds. This means that they can finance the purchase of inventory and investment using their own funds to a large extent, and this should reduce the need to borrow. Equally, the large share of liquid assets and own funds should allow them to borrow more easily and on better conditions. Having deposits and liquid assets may also encourage lending between non-financial companies, especially within groups.

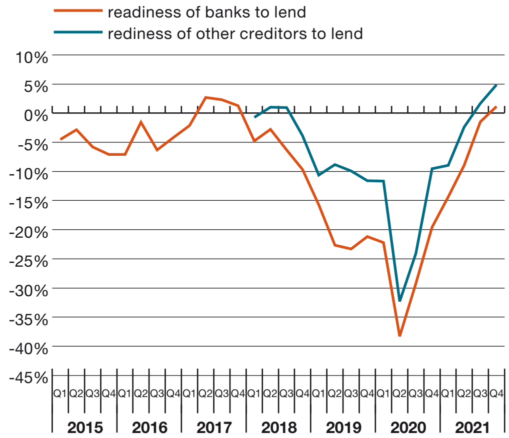
Corporate assessments of access to funding improved throughout 2021 and by the end of the year they were at their highest level of the past eight years (see Figure 16). Companies consider that the willingness of banks and other lenders to lend has improved. Funding opportunities have also recovered in most other European

Figure 15. Yearly growth of corporate profit, equity and deposits



*The figure does not include microprudential buffers
Source: Estonian Institute of Economic Research

Figure 16. Assessment by businesses of the lending environment



*The figure does not include microprudential buffers
Source: Estonian Institute of Economic Research

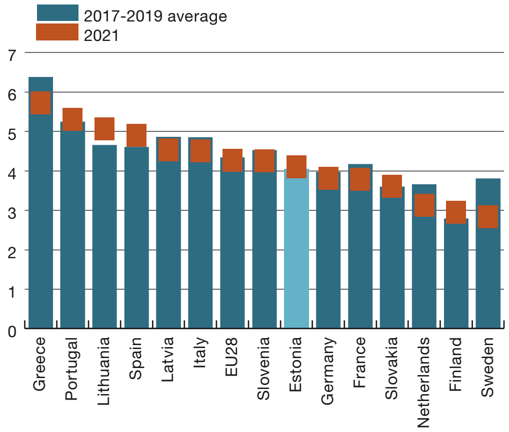
Union countries to where they were before the pandemic, after deteriorating in 2020 (see Figure 17). Estonian companies consider their position now to be a bit better than the average for companies in Europe.

Companies in real estate are the most satisfied with the lending climate, while companies in accommodation and food service and in transport are the most worried (see Figure 18). The good performance and access to loans of real estate companies is also reflected in faster growth in that sector's loans than in those to other sectors. The average interest rate on loans issued to the real estate sector has risen though, probably indicating that riskier projects are also

5 See *The loan supply from the banks and competition.*

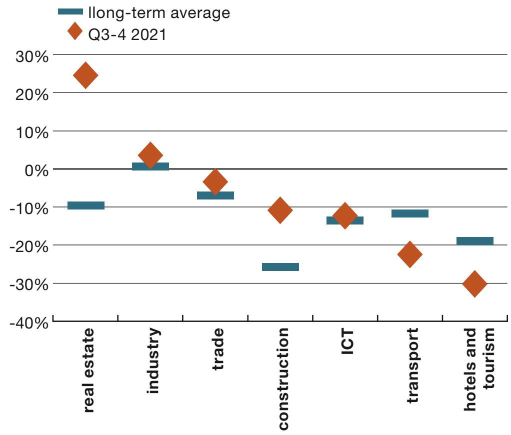
6 See The development of non-bank financial intermediation and Box 1 The role of the stock market in corporate funding.

Figure 17. Assessment by SMEs of access to external sources of funds*



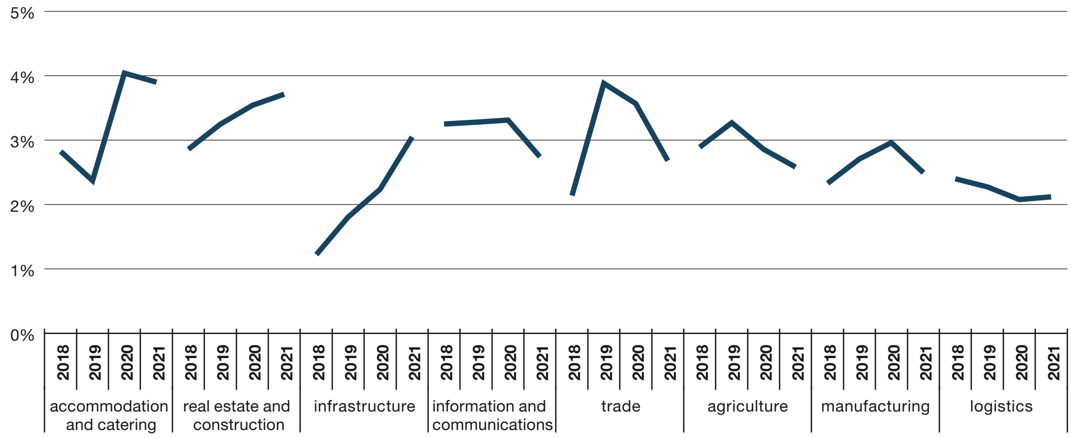
* 0 - does not affect business activities at all, 10 - affects business activities a great deal
Sources: European Central Bank, SAFE

Figure 18. Assessment by businesses of the readiness of banks to lend



The percentage shows the difference between the shares of respondents giving favourable and unfavourable assessments
Source: Estonian Institute of Economic Research

Figure 19. Average interest rates on long-term corporate loans

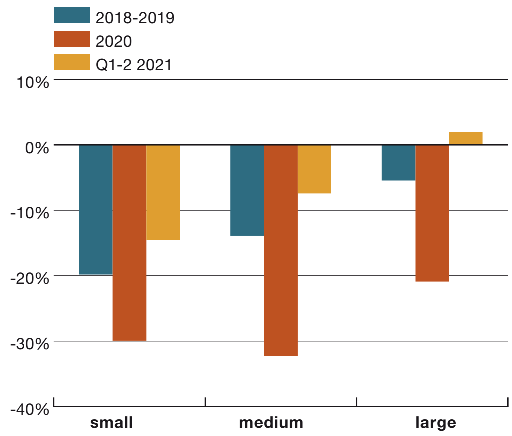


Source: Eesti Pank

receiving funding, and demand for real estate is high (see Figure 19). Access to funding remains bad for companies in accommodation and tourism, which is the sector hit hardest by the restrictions introduced to stop the spread of Covid-19, but the second half of the year was still better than the first half. The average interest rate was a little lower in 2021 for most sectors than it was in 2020.

Surveys showed that access to funding improved for companies in all the size groups. The most satisfied were again the largest companies with over 100 employees (see Figure 20), but the assessments by small companies have also improved. When interest rates rose some years ago in Estonia, it was the rates on the smallest loans, which are probably made to smaller companies,

Figure 20. Assessment by businesses of the readiness of banks to lend by size of company



The percentage shows the difference between the shares of respondents giving favourable and unfavourable assessments
Source: Estonian Institute of Economic Research

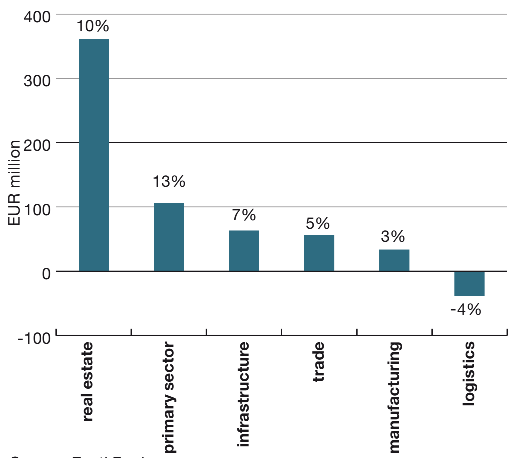
that rose the most. Now however, the interest rates on smaller loans have started to fall a little.

Loan growth accelerated in 2021. This reflects both increased demand and good access to loans. The stock of corporate loans issued by banks operating in Estonia grew by 7.4% over the year. The growth in short-term loans for less than a year was strong, having fallen substantially in 2020. The operating volumes of companies grew rapidly in 2021 and this increased their need for operating capital, and so the stock of short-term loans grew in consequence by some 20% over the year. There was no decline in the meantime in long-term loans, and the portfolio grew by 6.2% last year. Real estate and agricultural companies led the growth in borrowing throughout the year (see Figure 21). The Eesti Pank December forecast 2021 expects corporate indebtedness to grow at around 8% in the coming years.

Estonian companies are again worried about finding collateral for loans (see Figure 22). Companies in Latvia and Lithuania face the same problem. Companies in the Baltic states are smaller than the average in Europe and the credit risk policy of the bank groups has been similar in all three countries. It is particularly difficult for new companies and regionally-based companies to find collateral that is suitable for the banks.

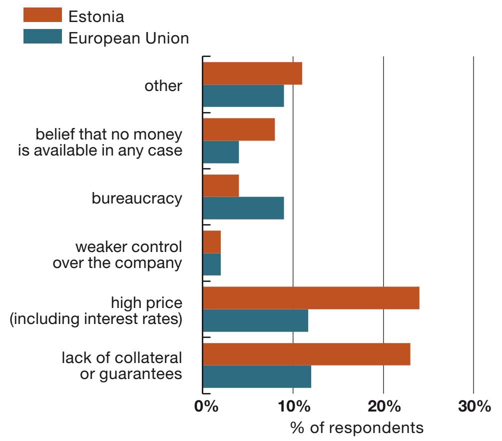
Estonian companies are also more worried than the average about high interest rates on loans. Interest rates for both large and small loans are higher in Estonia than elsewhere in the euro area. This makes the worries of businesses understandable, and the interest rates here largely reflect the weakness of competition next to that in the rest of Europe. Fast growth in the Estonian economy and in prices however mean that real interest rates are deeply negative, and the level of interest rates today is probably actually too low given the position of the economic cycle[7]. The average interest rate in the euro area would also be too low over the medium term for the position of the Estonian economic cycle, as inflation in Estonia will probably be higher than that in the euro area for some time yet. Higher interest margins support the profitability of the banks, their ability to cope with loan losses, and so the sustainability of their capacity to provide loans. Access to funding is more important for the sustainable development of the economy than loans having the lowest possible price, and the news on that front is good for Estonia. There may be more of a problem for the competitiveness of exporting companies, as Estonian companies have to compete in foreign markets with companies that have some advantage in the cost of financing.

Figure 21. Growth in the loan stock in 2021



Source: Eesti Pank

Figure 22. Factors posing the biggest obstacle to funding for companies in the years ahead



Sources: European Central Bank, SAFE

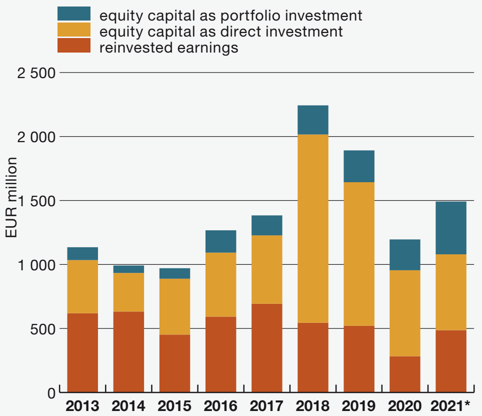
7 The OECD also pointed to excessively low interest rates in its 2022 review of the Estonian economy.

Box 2: Funding from abroad for Estonian companies during the Covid-19 pandemic

In the couple of years before the pandemic, funding from abroad for Estonian companies grew strongly to a record level. The growth came from borrowing from abroad, and especially from new investment in equity. The growth was led by information and communication technology, and professional, scientific and technical activities. When the measures taken against the pandemic were restricting the economy the most in 2020, funding from abroad for Estonian companies also declined. This was probably because changes occurred in demand and supply, and especially because levels of uncertainty were extremely high at that time and many economic interactions were put on hold at least temporarily. There was a partial recovery in funding from abroad in 2021, especially in investment in equity.

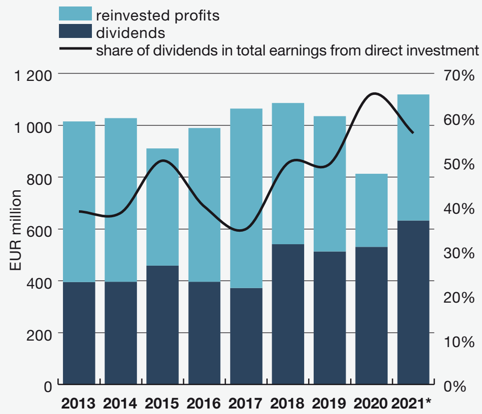
Foreign equity investment in Estonian non-financial companies was down by more than a third in 2020 (see Figure 23). Both the reinvested profit of foreign-owned companies and new foreign equity investment fell. This happened because the decline in the economy reduced corporate profits, but dividends were still paid out to the same extent as in earlier years. Foreign investors behaved in a similar way in the crisis of 2008-2009. As profits grew in 2021, so reinvested profits recovered (see Figure 24). The fall in new equity investment came mainly in the amounts invested, while the number of investment transactions fell less steeply.

Figure 23. Size and structure of foreign direct investment



* Q4 2020 - Q3 2021
Source: Eesti Pank

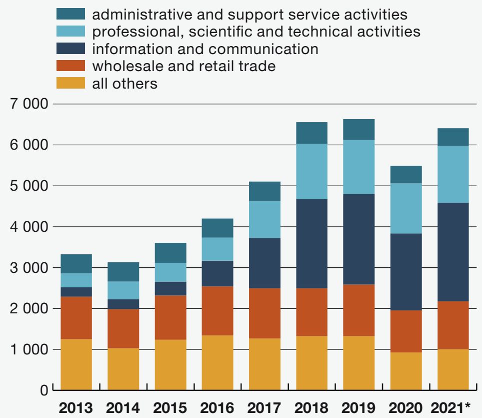
Figure 24. Profit earned in Estonia by foreign investors



* Q4 2020 - Q3 2021
Source: Eesti Pank

New equity investment in the past five years has gone mostly into information and communications, and professional, scientific and technical activities[8], both by amount and by the number of investments (see Figure 25). The growth in those two areas explains a large part of the growth in foreign equity investment before the pandemic and the partial decline in equity investments during the pandemic. New

Figure 25. Number of foreign direct investments by sector



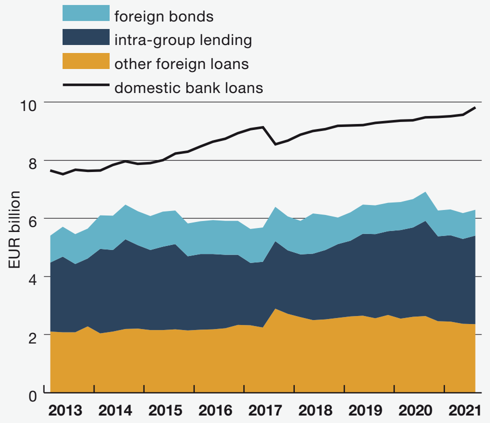
* Q4 2020 - Q3 2021
Source: Eesti Pank

8 Professional, scientific and technical activities technically covers investments in other areas, reflecting for example the activities of head offices, management consultancy, and legal work.

investment in those sectors has probably been encouraged by the good performance of the economy, while the additional foreign investment has equally helped the sector to grow.

The role of funding from abroad has declined a little in recent years. At the same time that domestic bank loans have grown steadily at a moderate rate, the level of foreign debt liabilities has remained around the same as it was five years ago (see Figure 26). Only intra-group loans have increased a little, which they also did during the first quarters of the pandemic. The volume of foreign bank loans and of bonds issued abroad has declined. Information and communications is practically the only area where borrowing from abroad has increased in recent years. It is possible that one reason why the share of credit coming from abroad has decreased is that access to domestic loans has improved. Unlike currently and throughout the pandemic, borrowing from abroad increased during the economic crisis of 2008-2010 and after it.

Figure 26. Foreign and domestic borrowing by non-financial companies in Estonia

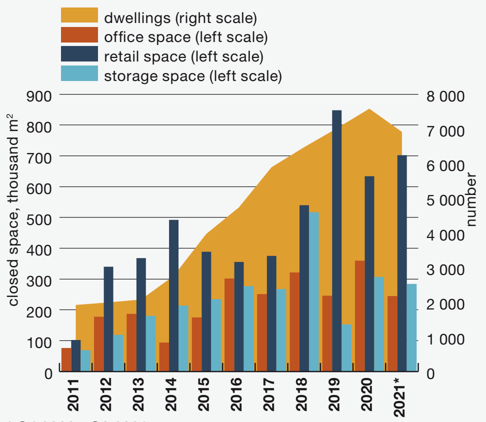


Source: Eesti Pank

Box 3: Financing of real estate companies

Real estate development has seen a lot of activity despite the recession that followed the outbreak of the pandemic, and the subsequent restrictions. Demand drove the housing market to recover rapidly after the initial shock and real estate developers have tried to maintain the supply of building materials despite the supply difficulties and price rises. Commercial real estate has also been built, extended and renovated at quite a quick rate (see Figure 27). At the same time, the bank loans to real estate companies have grown faster than those to other companies, and real estate companies have been active at raising funding by issuing shares and bonds.

Figure 27. Use permits granted for real estate during a year

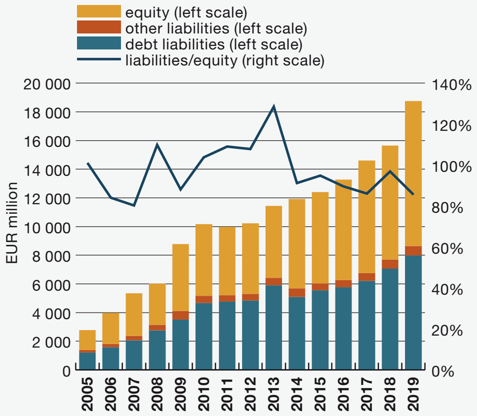


* Q4 2020 - Q3 2021
Source: Statistics Estonia

Funding for companies in real estate comes quite equally from own funds and external funds, and financial leverage has remained at a fairly unchanged level for several years. The volume of assets of real estate companies has grown fairly quickly since 2013. The growth in profits at the same time has allowed them to use reinvested income to increase their equity, though at times, including in 2019, equity has also grown because of additional equity investment. The latest data for the end of 2019 show that 54% of total assets were financed by equity, 43% by various debt liabilities, and the remaining 3% by other liabilities (see Figure 28).

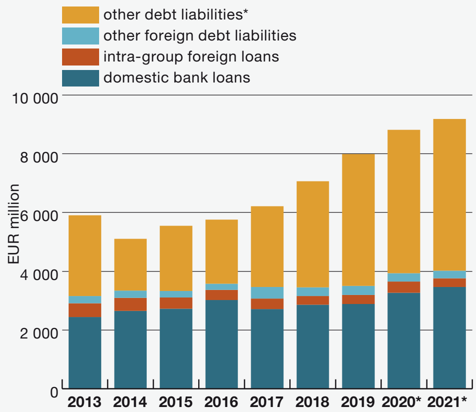
The largest part of debt liabilities are debt liabilities received from sources outside of domestic banking, and that share has been increasing strongly since 2017 (see Figure 29). The growth in

Figure 28. Liabilities and owner's equity of real estate companies



Source: Statistics Estonia

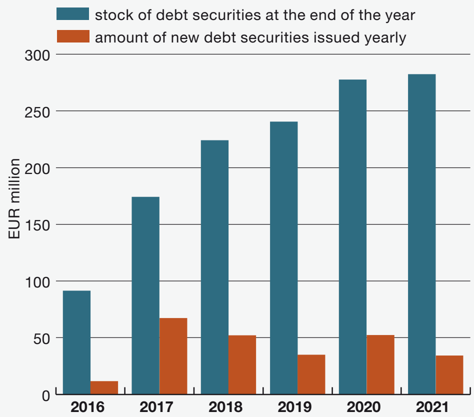
Figure 29. Debt liabilities of real estate companies



* Other debt liabilities estimated for the total non-financial corporate sector; data for 2021 as of Q3
Sources: Statistics Estonia, Eesti Pank, Eesti Pank calculations

loans and leases received from banks operating in Estonia has been substantial, but their share in liabilities has fallen from more than 50% of all the debt liabilities of the real estate sector five years ago to 38% in the third quarter of 2021. The share of money that was received from foreign creditors has also declined a little, and it had fallen to 6% by the third quarter of 2021[9]. This means that some 50-60% of the debt liabilities of real estate companies came from sources other than domestic banks. There can be many different types of such sources, like other financial institutions such as investment funds, or loans and bonds taken from other companies or private individuals. It is estimated that in a large share of cases the funding is still coming in loans from outside the companies, including intra-group lending. The growth in lending between companies has however not been restricted only to real estate companies, but is a sign that economic activity has increased.

Figure 30. Debt securities issued and registered by real estate companies



Source: Statistics Estonia

Real estate companies also finance their activities by issuing bonds, but the role of bonds in funding is still estimated to be small. Market participants say that interest in bonds has increased in recent years among both issuers and investors. The bonds issued by real estate companies and registered in the Estonian Central Securities Depository[10] show that the amount issued in registered bonds has indeed increased since 2017 (see Figure 30). It is still small though in terms of total financing, as seven bond emissions were registered last year for a total value of 34 million euros, which was around 2.7% of the total value issued in bank loans. The total amount of bonds issued by real estate companies that have not reached maturity has increased year on year, and it stood at around 280 million euros at the end of 2021. This means that real estate companies raise about 5% of their other debt liabilities and 3% of all of their external funds by issuing registered bonds[11].

9 The share of loans from foreign lenders may be a little larger though, as some of the foreign loans of the real estate sector are recorded for reporting purposes under debt liabilities of other and undefined sectors.

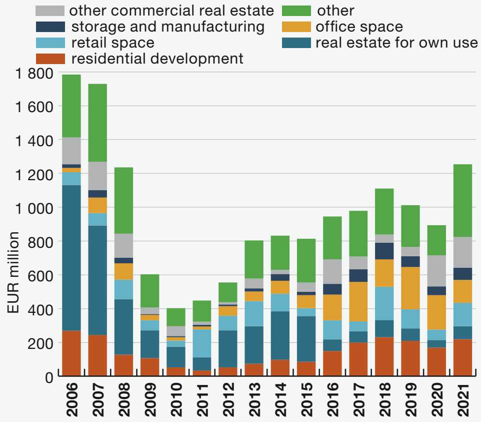
10 Issues have to be registered with the Estonian CSD if it is planned to issue or offer the securities to the public or to submit them for trading on the regulated market.

11 These estimates are a little underestimated for the bond market as a whole, as alongside the registered bonds, some bonds are issued to direct purchasers for whom there are no data.

Real estate companies also fund themselves through crowdfunding platforms, but the funding raised in this way is quite small as a share of total funding. The amount of money received by real estate companies through crowdfunding platforms registered in Estonia is estimated by Eesti Pank to have been around 50 million euros at the end of 2021[12]. This meant that funds received from crowdfunding financed around 1% of the debt liabilities of real estate companies, though that share is probably larger for the financing of housing development.

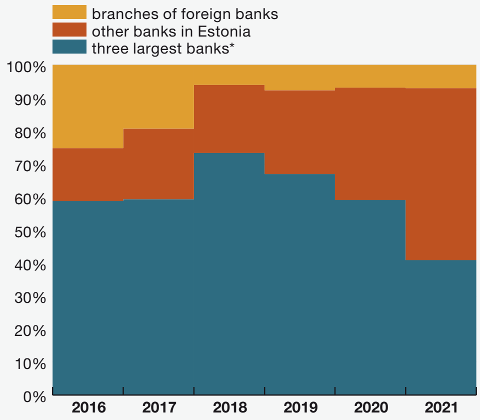
The growth in bank loans to real estate companies has accelerated from the second half of 2020, and has been driven especially by the smaller banks. The banks operating in Estonia issued a total of 1.25 billion euros of new loans to real estate companies in 2021, which was 40% more than in 2020 and 24% more than in 2019 before the pandemic (see Figure 31). Domestic banks have been the most active in the market to lend to real estate companies in recent years. The market share of foreign-owned banks has decreased (see Figure 32). Financing for large office space was predominant in the previous couple of years, but in 2021 the growth appears to have been more in funding for trading space and commercial property for other purposes.

Figure 31. New banks loans to real estate companies by purpose



Source: Eesti Pank

Figure 32. New bank loans to real estate companies by groups of banks



* Swedbank, SEB Bank and Luminor.
Source: Eesti Pank

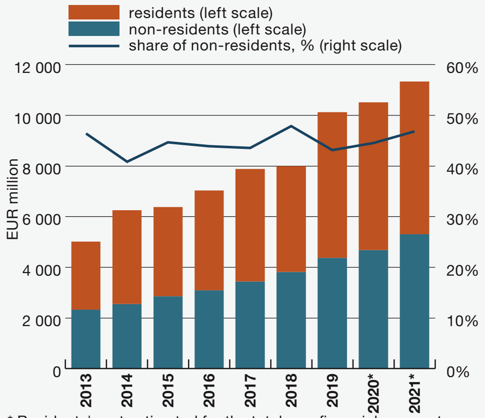
Some of the bank loans to real estate companies have been taken to leverage the investments of real estate funds. More and more real estate funds have come to the market in recent years. There were 13 funds investing in real estate operating in Estonia at the end of 2021, and the total value of their assets was estimated at around 1.3 billion euros. Investments are mainly managed by setting up separate companies that are then financed partly by selling fund units and also by bank loans. The financial leverage of the funds generally remains at around 40-60%, but there are also funds that do not use leverage at all. The volume of loans taken from Estonian banks to leverage the fund investments was estimated from the public reports currently available at around 200 million euros at the end of June 2021, which is around 5% of the bank loans of real estate companies and some 2% of their total debt liabilities.

Real estate funds mainly invest in shopping centres and office buildings, and a large number of them invest large amounts in Latvia and Lithuania as well as in Estonia. The current financial reports show that 52%, or just over half, of the investment of real estate funds was in shopping centres, around 30% was in office buildings, 10% was in storage space, and 4% was in land. it is also apparent that the investment portfolio has become more diverse than it was a few years ago, which is probably because there are not many projects in the markets that are worthy of investment. Around 36% of the fund investment goes to Estonia, while the rest is mainly split

12 The data are compiled from the websites of crowdfunding platforms and the annual reports of companies managing them.

quite evenly between Latvia and Lithuania. The bank financing of projects in Latvia and Lithuania comes mainly from the subsidiaries or branches of Estonian banks operating in those markets.

Figure 33. Owner's equity of real estate companies by sources



* Residents' part estimated for the total non-financial corporate sector; data for 2021 as of Q3
Sources: Statistics Estonia, Eesti Pank, Eesti Pank calculations

Non-residents have mainly put money into Estonian real estate companies in the form of equity, and the volume of intra-group or other external loans is small. Although equity investment by non-residents has increased considerably over the years, it has not particularly increased as a share of the equity of real estate companies, and has remained at 40-50% for years (see Figure 33). Equity investment for non-residents has increased through both reinvested income and additional equity injections. The volume of reinvested income has however remained quite stable over the years, and equity has started to provide a diminishing share.

In summary, real estate companies have managed to receive funding during the difficult times of the pandemic from both external capital and from equity. The rapid recovery in demand in the real estate market and in the sales revenues and profit indicators for real estate companies have meant that various sources of funding have been available to companies. The most recent data show a particular increase in the share of non-bank domestic financing, which mainly comes from inter-company loans. The role of other market-based sources of funding like bonds and crowdfunding is increasing, but it remains small. Increased competition in the corporate loan market indicates at the same time that the smaller banks have become more active than earlier, and so access to loans and lending conditions have become more favourable for companies. Non-residents provide financing for real estate companies primarily through equity, and their share of the ownership of companies has not particularly changed over the years.

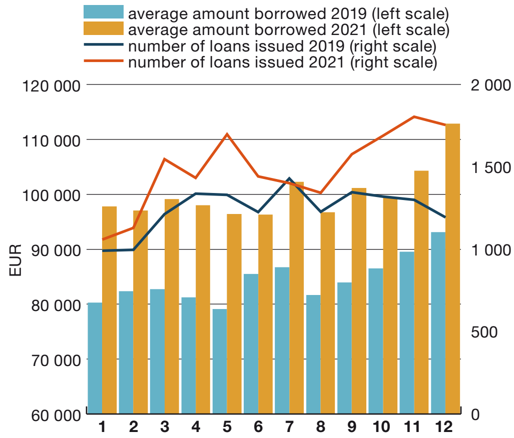
4. ACCESS OF HOUSEHOLDS TO FUNDING

Rising incomes and confidence supported households in their ability and desire to borrow in 2021. Household incomes continued to rise rapidly in 2021, with the average gross wage up by 7.8% in the third quarter. Wages were also rising rapidly in the middle of the year in those sectors that had earlier been hit hard by the pandemic. The deposits put aside in the previous year through forced savings and savings built up because of uncertainty were supplemented in autumn 2021 by the amounts paid out from the second pension pillar. Strong growth in assets increased the capacity and confidence of households for borrowing. Looking forwards, household confidence and their borrowing may be reduced by the general rise in inflation from autumn 2021, and by the return of uncertainty in the economic environment.

The banks managed to cope well with the sharp increase in demand for housing loans that continued throughout 2021. The stock of housing loans issued by the banks stood at around 9.4 billion euros in December. The growth in housing loans stood at 9.3% at that moment, which was its highest level for a decade. The volume of housing loans issued to households in the fourth quarter was almost 40% larger than in the same quarter of the previous year. Almost 25% more than a year earlier has been issued in housing loans since the payouts started to be made from the second pension pillar assets in September, but the total value of new housing loans has grown primarily because the average amount borrowed has increased. This reflects the sharp rise in prices in the real estate market (see Figure 34). The total amount issued in housing loans by the banks stood at a record level at the end of the year, but the turnover of housing loans as a share of real estate transactions has fallen a little in recent years, and it was a little under 60% in the third quarter of 2021 (see Figure 35).

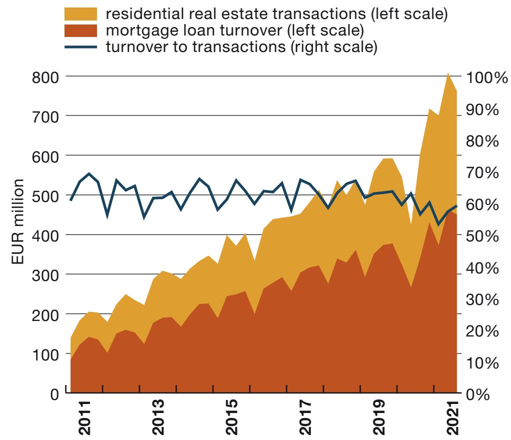
Survey results also reflect the willingness of banks to meet the increased demand for housing loans. Banks responded to the bank lending survey in the euro area in 2021 that demand for housing loans had increased throughout the previous year, and they said

Figure 34. Average amount and number of housing loans issued



Source: Eesti Pank

Figure 35. Mortgage loan turnover to residential real estate transactions



Sources: Estonian Land Board, Eesti Pank

there was no meaningful change in the share of applicants they rejected. A much larger share of households than previously responded to the survey of the financial behaviour of private individuals that their application for a housing loan was accepted[13] (see Figure 36). At the same time the results of the bank lending survey indicated that the standards for housing loans had eased[14]. This indicates that the banks have loosened their guidelines or criteria for their lending policies over the past year[15].

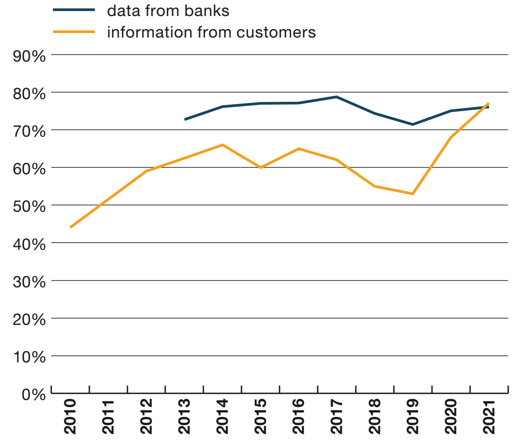
The survey results showed that access to housing loans improved for households with

13 RAIT Faktum&Ariko. Survey of the financial behaviour of private individuals. September 2021.

14 See *The loan supply from the banks and competition.*

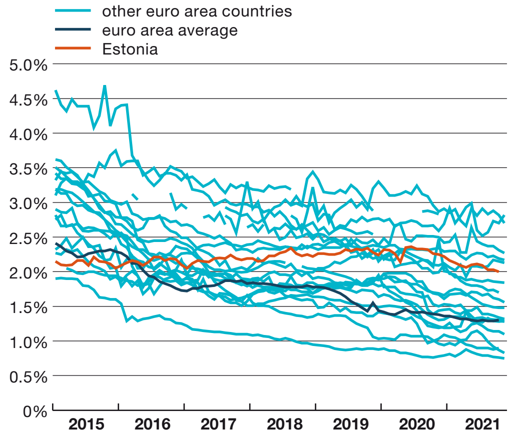
15 The lending standards specify the details needed about the borrower such as their income, age and job. They also define what can and cannot be accepted as collateral for the loan.

Figure 36. Applications for housing loans granted as a share of applications from households



Sources: Eesti Pank, RAIT Faktum&Ariko

Figure 37. Average annual interest rate on new housing loans



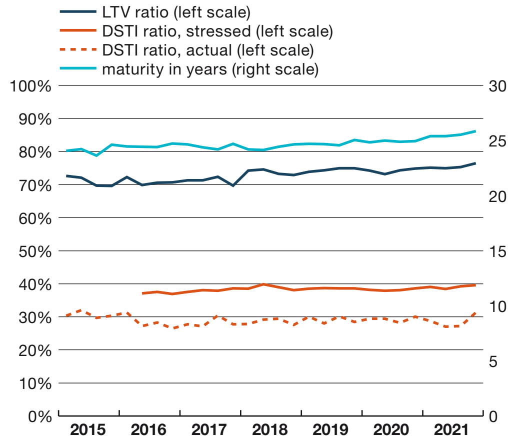
Source: European Central Bank

low incomes in 2021[16,17]. The survey at the end of summer indicated that, as in the previous year, the level of satisfaction of applications for housing loans was higher when household incomes are higher. The share of applications for housing loans that were accepted was similar for households with middling incomes and for those with higher incomes at around 85%.

Access to housing loans was better for all age groups in 2021 than a year earlier, and especially so for younger people. Surveys showed that most of the applicants for housing loans were aged 25-34, and the share of applications accepted was also largest for this age group at 85%.

The issuing conditions for housing loans have eased somewhat. The banks told surveys that this is because of increased competition in the banking market. The average interest rate on housing loans issued to households fell throughout 2021, and in November the average interest rate for housing loans with a mortgage hit a record low of 1.95%. Even so, the average interest rate in Estonia remains notably higher than the average in Europe (see Figure 37). Like in earlier years, 90% of the housing loans issued in Estonia in 2021 had a floating interest rate. The average value of the debt service-to-income ratio in the stress scenario of the interest rate rising to 6% moved slightly upwards during 2021. The average maturity of housing loans rose at the same time by almost a year, and the average loan-to-value ratio has also risen. If the interest rate had

Figure 38. Weighted average LTV and DSTI ratios and loan maturity



Sources: Finantsinspektsioon, Eesti Pank

not fallen, these other changes would have been smaller (see Figure 38).

The volume of leases issued by banks recovered during 2021 to where it was before the pandemic. The average monthly turnover of car leases was 7.8% more in 2021 than in 2019. The average interest rate on car leases has fallen for a year and a half (see Figure 39).

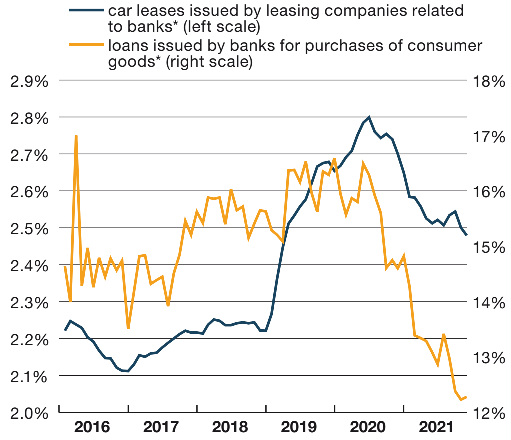
Competition in the market for consumption loans may be pushing the interest rates on bank loans downwards The volumes of new consumption loans issued by banks and by other creditors remained lower than before the pandemic. The banks say that demand for consumption loans fell in the third quarter, possibly because

16 RAIT Faktum&Ariko. Survey of the financial behaviour of private individuals. September 2021.

17 The share may also have increased because the sample is small.

households had larger savings and because of payouts from the second pension pillar. Even so the share of applications for consumption loans rejected by the banks increased in the second and third quarters, and the standards set by the banks for consumption loans did not change during the year. The margins on the consumption loans issued by the banks narrowed noticeably during the year. The banks said that this is because of the pressure of competition.

Figure 39. Interest rate on new car leases and percentage rate of charge on consumer loans



* three-month moving average
Source: Eesti Pank

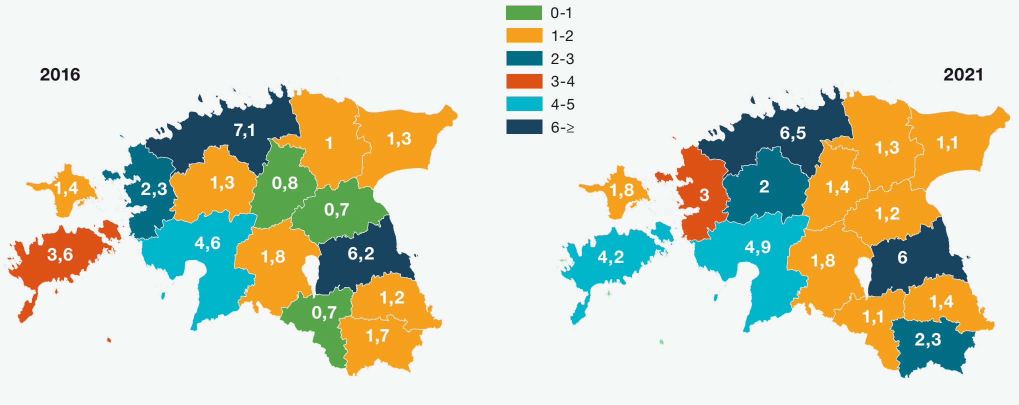
Box 4. The affordability of housing

The affordability of real estate in Estonia has not particularly changed over the past five years even as real estate prices have risen. This varies greatly across regions though, and Tallinn stands out for its high price level.

Affordability indicators show the ability of households to purchase residential property. As loans are often used to purchase residential property though, it is reasonable when looking at the affordability of residential property to consider access to housing loans as well, which is affected by the income of the borrower and by the conditions of the loan.

The affordability of housing varies across the regions of Estonia. The median multiple, which shows the ratio of housing prices to annual salaries, is a commonly used indicator for the affordability of housing. It shows how many median family salaries would be needed to buy a median-sized apartment. This indicator internationally uses thresholds of 3.0 and 5.0, where a value for the index of up to 3.0 means that real estate is affordable, and a value of 5.0 or more means that buying residential property is substantially beyond the reach of the population. The affordability index is very different in different counties in Estonia in 2021 (see Figure 40). The values for the index in Harjumaa and Tartumaa were above 5.0, meaning that the cost of housing in those

Figure 40. House purchase affordability index for Estonia by region*



* data for 2021 are for Q3
Sources: Statistics Estonia, Tax and Customs Board, Eesti Pank calcualtions

regions was beyond the threshold of affordability. The median multiple has risen in almost all regions over the past five years, except in Harjumaa and Tartu, where it has come down a little. The affordability index for Estonia stood at 2.8 in the third quarter of 2021.

The index for Tallinn was at 7.3 in the third quarter of 2021, which means that someone earning the median wage who has taken a loan to buy an apartment at the median price would take 7.3 years to repay the loan in full if they spend all their wages on nothing but that. Data from the Landgeist Maps agency show that the median multiple in the second quarter of 2021 was 30% higher in Helsinki than it was in Tallinn and 40% higher in Stockholm, and it was 3% lower in Riga than it was in Tallinn[18].

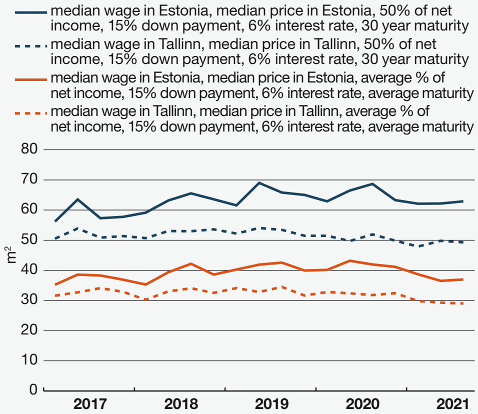
The affordability of housing can be described by looking at how much of the monthly wage of somebody receiving the median wage would go on loan payments if they used a loan under applicable lending conditions to buy an apartment of average size and price[19]. Requirements on issuing housing loans were introduced by Eesti Pank in 2015 and state that loan repayments may not be more than half of the net income of the borrower, and that the calculation of the maximum repayment of the loan has to use the interest margin in the loan contract plus two percentage points or an annual rate of 6%, whichever is higher. The maturity of loans may not exceed 30 years.

The options for borrowers are discussed here given the Eesti Pank requirements and the actual average loan maturities and loan-to-income ratios allowed by banks.

The number of square metres that can be bought on the median wage using a loan at the maximum terms of the restrictions has increased slightly in Estonia overall over the past five years. At the end of the third quarter the median wage in Estonia was able to buy a median-priced apartment of around 60m² (see Figure 41). If the borrower wanted to take a bank loan issued with the average debt service-to-income ratio, loan maturity, and down payment though, the Estonian median wage at the end of the third quarter was able to buy a median-priced apartment of around 37 m². The median income for one person would not be sufficient to buy an apartment of median size in Tallinn, and the number of square metres that could be afforded has declined a little.

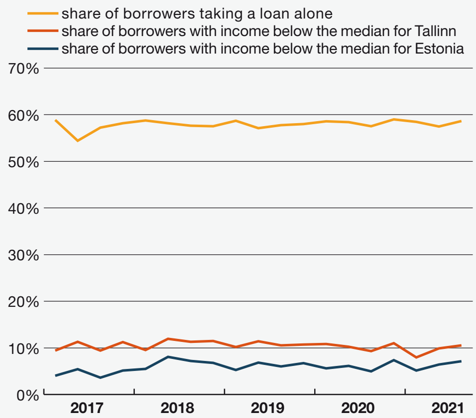
It was calculated that in the third quarter of 2021 only a little over half of wage earners in Estonia as a whole could afford an apartment of median size, and only a third of those in Tallinn could[20]. A borrower wanting to buy an apartment of 56m² at the median price in

Figure 41. Number of square metres in a median-priced apartment in Estonia and in Tallinn that can be bought with a loan at the median wage



Sources: Statistics Estonia, Estonian Land Board, Eesti Pank

Figure 42. Share of solo borrowers and of borrowers with incomes below the median



Sources: Statistics Estonia, Estonian Land Board, Eesti Pank

18 https://landgeist.com/2021/11/30/home-purchase-affordability-in-europe/.

19 The average apartment bought in Estonia in the past five years has been 56 m².

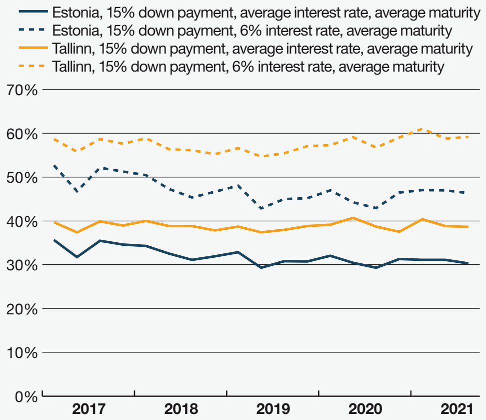
20 Wage data from Statistics Estonia, assuming a debt service-to-income ratio of 50%.

Estonia would need a monthly net income of over 900 euros, or of 1250 euros in Tallinn. In reality only 3% and 17% of loans were issued to borrowers with these or lower levels of incomes in 2021.

The share of borrowers with low incomes has increased a little over time. Some 7% of housing loans issued in the third quarter were taken by borrowers with an income below the Estonian median, and 11% were taken by borrowers with an income below the median for Tallinn (see Figure 42). The actual median net income of borrowers was 2100 euros in 2021.

Rising real estate prices have not increased the share of joint borrowers. Some 60% of housing loans covering 50% of the value of those loans are issued to individual borrowers with one person's income, and this has changed little.

Figure 43. Loan costs from the local median wage for a 56m² apartment at the median price in Estonia and in Tallinn



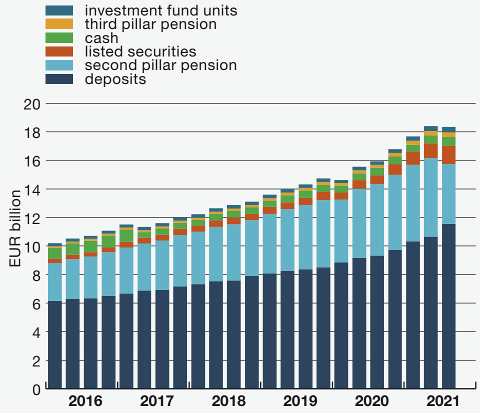
Sources: Statistics Estonia, Estonian Land Board, Eesti Pank

Lower interest margins have reduced the actual loan service costs (see Figure 43). Increased competition has brought the interest margins on new loans down to close to 2%. Negative interest rates are generally not applied for Estonian retail clients, and the margin starts from zero when loan costs are calculated. The primary monthly loan costs for buying a median-sized apartment of 56m² at the median price has come down to around 30% of the median wage for the whole of Estonia and to 40% in Tallinn as margins have shrunk. If interest rates on such loans were to rise above 6%, the borrower on the median wage in Estonia would still have more than 50% of their net income available to cover other costs, and the borrower on the median wage in Tallinn would have about 40%.

Box 5: The financial assets of households have increased rapidly

The increased capacity to save has meant that the financial assets of households have increased in volume by some 70% over the past five years to more than 18 billion euros (see Figure 44). Although many people still have few savings, the share of households with financial savings[21] had increased by September 2021 to around 80%. In 2016 this figure was 67%[22]. On top of the rise in incomes, saving has been boosted in the past couple of years by the forced saving during the pandemic and by saving driven by uncertainty. Savings have increased for almost all socio-economic groups, but particularly so for people on higher incomes and for younger people. Although deposits and the second pension pillar

Figure 44. Financial assets of households

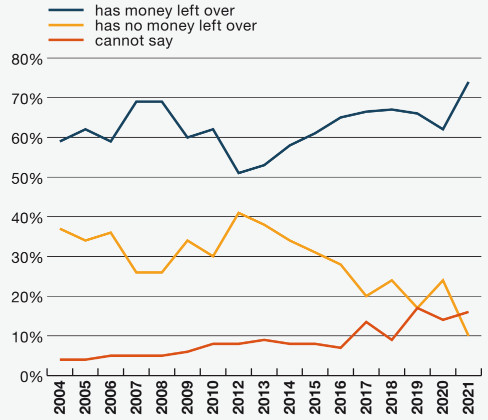


Source: Eesti Pank

21 Meaning people who own cash, bank deposits, third pillar pensions, marketable securities, fund units, investments in crowdfunding platforms, and crypto assets.

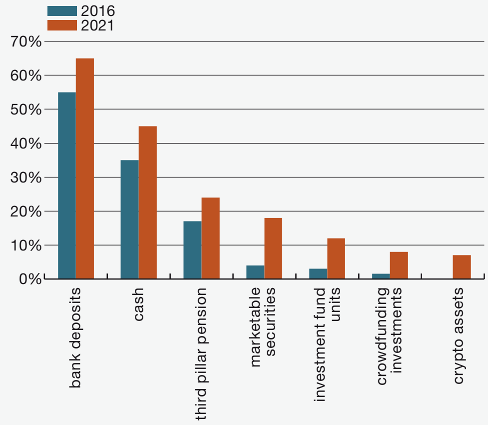
22 Survey of the financial behaviour of households.

Figure 45. Share of families with money left over after essential spending and loan liabilities



Source: Eesti Pank

Figure 46. Share of households owning financial assets



Source: Eesti Pank

continue to dominate among financial assets, the structure of financial investment has become more diverse. This has happened because interest in it has increased and investment opportunities have improved.

The main driver of growth in financial savings has been the improved capacity to save. The survey of the financial behaviour of private individuals shows a notable increase since 2016 in the share of families who have money left over after spending on essentials (see Figure 45). Surveys by the Estonian Institute of Economic Research also show a substantial increase over the past five years in the share of families with savings. The survey of the financial behaviour of private individuals finds that some 39% of people saved more than usual during the pandemic.

The amount held as deposits on the bank accounts of households has grown over the past five years by some 5 billion euros, and it stood at around 11 billion euros at the end of 2031. Growth in deposits has been particularly strong during the pandemic. In 2020 and in the first half of 2021, when there was a lot of uncertainty and of restrictions, people consumed less and so deposits grew notably more than before the pandemic. Since March 2020, deposits have been up over the year by as much as 1.5 billion euros. As society has largely adapted to the pandemic over the past six months, consumption has returned to normal, and deposits have grown at the rate they did before the pandemic. Money withdrawn from the second pension pillar since September 2021 has been added to savings though, increasing them by around a billion euros.

The next most popular place for households to put their money is the second pension pillar, which contained 4.2 billion euros at the end of the third quarter of 2021. Before the payouts were made from the pillar it stood at 5.5 billion euros, having increased by more than 2.5 billion euros over the preceding five years. The rapid growth of around 80% was driven by additional contributions and by a rise of some 30% in the value of the assets.

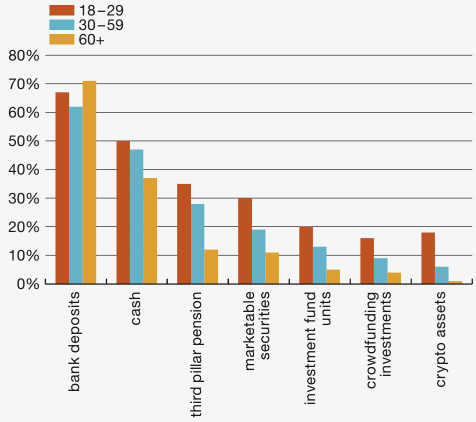
The third pension pillar was less commonly used for many years, but it has become much more popular in the past couple of years. The number of third pillar pension accounts has risen in just two years from 75 thousand to around 175 thousand[23]. The volume of assets increased in five years by around 80% to 320 million euros. Holders of third pillar pensions have on average benefited more from rising asset prices than second pillar pension holders have, as they have generally chosen funds that are more volatile but faster growing, like equity funds.

More money has also been put into investment funds, especially abroad. At the end of the third quarter of 2021, households had put 390 million euros into investment funds, of which 80 million euros was invested in domestic funds, and 310 million in funds registered abroad. Growth

23 The number of pension accounts with a balance greater than zero has increased from 44 thousand to 138 thousand.

has been notably faster in those foreign funds in the past five years, and especially in 2021. Around two thirds of the growth of 90% or so over the past five years in the value of the funds has come from additional investments in them, and a third has come from the rise in the value of the assets.

Figure 47. Share of people owning financial assets by age group



Source: Eesti Pank

The value of marketable securities held by private individuals has more than quadrupled over the past five years, and it stood at 1.3 billion euros at the end of September. A little under half of this with a value of 607 million euros is in foreign securities. The volume of securities held by households has increased by around a billion euros over the past five years, and the growth is roughly evenly split between the 500 million euros that has come from additional investment, and the 500 million that has come from growth in the value of the assets. The actual volume of securities held by households is probably even larger, as many handle their investments through companies.

The amount of cash held by private individuals has probably also increased over the past five years. Although there are no precise data on the amount of cash held by households, indirect data and survey data indicate that cash savings have been gently but steadily increasing while interest rates have remained low. The financial account data put together by Eesti Pank show that households had some 600 million euros in cash at the end of the third quarter of 2021.

There are equally no precise data on the savings invested in alternative investment options like crowdfunding and crypto assets, but it is probable that they have seen rapid growth in the past five years. It can be indirectly estimated that people from Estonia have put up to 200 million euros into crowdfunding. This would be around twice as much as the amount of savings put into savings and loan associations, though this amount has also almost doubled over the past five years.

Survey data show that there has also been an increase in the past five years in the number of people with different financial savings (see Figure 46). This has happened for all the main types of financial asset. People still mostly hold their financial savings on bank accounts, and some two thirds of people had savings there in autumn 2021[24]. The increased popularity of marketable securities and the third pension pillar is further confirmed by the very rapid growth in the number of securities accounts that have been opened and by data from the Estonian Funded Pension Registry, Pensionikeskus. Survey data show a leap in recent years in the popularity of alternative investment options like crowdfunding and crypto assets.

The share of wealthier and younger people with financial assets is larger (see Figure 47). It is only bank deposits and cash where wealth and youth are less of a decisive factor. Other socio-economic factors have less of an impact on financial savings, but it may still be noted that Estonians tend to prefer bank deposits, securities and the third pension pillar, while people of other nationalities hold more of their savings in cash.

The group of people who own financial savings has increased over the past five years particularly through younger people and people on higher incomes. There has also been growth in other groups though, and it is interesting to note that growth has been fairly equal regardless of education level.

24 This calculation covers money that has been specifically put aside, not money that is kept for managing from payday to payday.