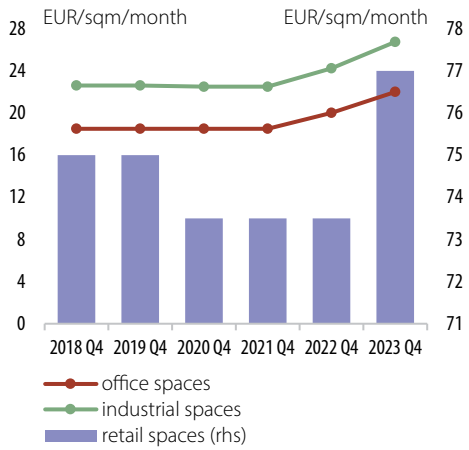
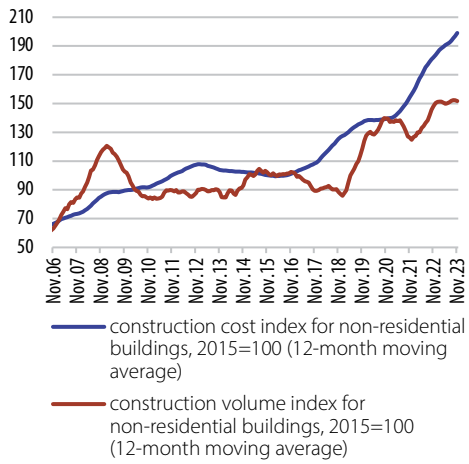
Box 8. Challenges to financial stability from the commercial real estate market

The dynamics of commercial real estate (CRE) markets have raised increasing concerns at European and global level. At the EU level, according to the latest assessments made by the European Central Bank, the CRE market has continued its downturn, in a context of tighter financial conditions and macroeconomic uncertainty, which resulted in lower demand, particularly for office buildings and retail spaces. Commercial real estate market activity in Romania slowed down in the first part of 2023, in line with regional developments. The analysis is based on the ESRB methodology for the assessment of vulnerabilities in the commercial real estate market, across four different risk stretches: collateral stretch, income and activity stretch, financing stretch and spillover stretch.

Chart A
Prime rents in Romania



Source: iO Partners



Source: NIS, NBR calculations

Chart B
Costs and the construction activity in the commercial real estate market in Romania

The collateral stretch assesses developments in prices in CRE sub-sectors and segments. In comparison with CRE markets in Western Europe, those in Central and Eastern Europe (CEE) experienced a smaller price correction over the past year. At national level, the analysis of end-2023 data highlights that a mixture of weakening supply and further steady demand, along with inflation and cost stabilisation at high levels, resulted in an increase in rents in the last year. Specifically, in 2023 prime rents rose for office and industrial spaces, as well as for retail spaces (Chart A).

The income and activity stretch assesses investment in the CRE market and the income generated by CRE properties. In 2023, the volume of CRE investment across CEE countries recorded a 10-year low, shrinking by 52 percent year on year, in line with European and global developments. Investment activity in the commercial real estate market in Romania also posted a significant decline, the volume of investment falling by approximately 60 percent in annual terms in 2023. Nevertheless, the volume of construction works for non-residential buildings rose marginally in the year under review, despite the higher construction costs (Chart B).

The financing stretch assesses the main vulnerabilities related to CRE exposures held by financial institutions. The exposure of the banking sector to the commercial real estate sector is elevated, accounting for about 50 percent of total loans to non-financial corporations at end-2023. The quality of the CRE loan portfolio is lower than that of the aggregate portfolio of loans to non-financial corporations, even though it has improved, amid the lower NPL ratio for both loans granted to companies in the construction and real estate sectors and loans secured by real estate. The breakdown by type of interest rate shows that floating rate loans make up the largest share of the CRE loan portfolio (93 percent). Funding costs for construction and real estate companies rose substantially, amid the higher interest rates, in line with developments across the entire non-financial corporations sector.

The spillover stretch assesses the risks stemming from interconnectedness between economic and financial sectors in relation to CRE domestically and globally. The analysis reveals a series of vulnerabilities. On the one hand, the funds invested in the CRE market in 2023 came primarily from the United Kingdom (47 percent), domestic investors contributing only 27 percent. On the other hand, firms operating in the commercial real estate market are largely funded by non-residents and hold around half of the medium- and long-term external private debt (including in the form of foreign direct investment) of the non-financial corporations sector as a whole. Moreover, these funds are rather highly concentrated depending on the country of origin, four countries (the Netherlands, Austria, Cyprus and Germany) accounting for 70 percent of total.