

Case No: 70382
Event No: 662781
Decision No: 298/14/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 16 July 2014

to close the case concerning existing aid to the Icelandic Housing Financing Fund
(*Íbúðalánasjóður*)

(Iceland)

The EFTA Surveillance Authority (“the Authority”),

HAVING REGARD to:

The Agreement on the European Economic Area (the “EEA Agreement”), in particular to Articles 61(1) and 62(1)(b) and Protocol 26 to the Surveillance and Court Agreement,

Protocol 3 to the Surveillance and Court Agreement (“Protocol 3”), in particular Article 1(1) of Part I and Article 19(1) of Part II,

WHEREAS:

- (1) The Icelandic Housing Financing Fund (“HFF”) is a State-owned institution, which operates on an arms-length basis under the Icelandic Housing Act no. 44/1998 (as amended). HFF is managed by a board of directors within the administrative purview of the Minister of Welfare. The purpose of HFF is to promote security of, and equal rights to, housing. This is done through the granting of mortgages to individuals and loans to entities that provide rental accommodation, and through the general organisation of matters relating to housing. Funding is provided for the specific purpose of increasing people’s prospects of acquiring or renting housing on manageable terms.
- (2) As set out in Decision No. 247/11/COL¹ of 18 July 2011, HFF benefits from State support in the form of a state guarantee on all of its obligations, interest support from the State to cover losses resulting from lending below market rates to entities that construct and provide rental housing to certain socially disadvantaged groups of people, an exemption from income tax as well as the absence of a requirement to make dividend payments to the State.²
- (3) By that Decision, the Authority informed Iceland pursuant to Article 18 of Part II of Protocol 3 that the financing of HFF was no longer compatible with the EEA Agreement.

¹ Available at <http://www.eftasurv.int/media/decisions/247-11-COL.pdf>.

² For a more detailed description of the aid measures, the functioning of HFF and the procedure preceding the adoption of Decision No. 247/11/COL, the Authority refers to the descriptions contained in Decisions No. 405/08/COL and 247/11/COL.

The Authority proposed the following appropriate measures to ensure compatibility on the basis of Article 61(3) of the EEA Agreement:

- To introduce changes to the general HFF loans system, as identified in the judgment of the EFTA Court in Case E-9/04, such as cost and size limitations of the eligible dwellings, in order to reflect the nature of the service of general economic interest (“SGEI”) entrusted to HFF, which is to assist an average citizen in financing of his or her own housing;³
- To limit the definition of SGEI entrusted to HFF in the field of rental housing loans to financing of purchase or construction of rental dwellings for the specific purpose of increasing people’s chances of renting housing on manageable terms. This could be done by introducing certain caps on the cost and size of the house or the apartment and on the income (or other relevant characteristics) of the eligible tenants;
- To revise loan categories approved by the Minister by means of Regulation No 458/1999, as amended⁴, with a view to bringing them in line with the changes to be made to the general loans scheme and the loans for rental housing of HFF, as requested by means of the appropriate measures;
- To clarify whether the Icelandic legislation on housing policy aims at benefiting Icelandic citizens only or all residents of Iceland (in particular including foreigners from other EEA states) regardless of their nationality. In this context, the Icelandic authorities are requested to confirm that the application of the Icelandic housing policy does not discriminate against other EEA citizens;
- To clarify the details of compensation to HFF, once the loan categories have been defined in accordance with the requirements of Article 59(2) of the EEA Agreement, in line with the Chapter on public service compensation of the Authority’s State Aid Guidelines.⁵ Appropriate mechanisms must be put in place to avoid overcompensation and to recover overcompensation which is not in line with the Authority’s guidelines;
- To ensure separation of HFF’s accounts in line with the Transparency Directive⁶, provided that HFF will continue to be engaged in economic activities other than the provision of services of general economic interest entrusted to it.

- (4) The Icelandic authorities informed the Authority of their acceptance of the appropriate measures in a letter dated 6 October 2011 (Event No. 610792), completed by further information submitted in particular on 5 June 2012 (Event No. 637062), 7 October 2012 (Event No. 648980), 7 January 2013 (Event No. 658858) and 22 May 2014 (Event No. 709426). The Authority also consulted with the complainant, the Icelandic Financial Services Association, who provided extensive comments on the proposed Icelandic

³ Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v EFTA Surveillance Authority*, [2006] EFTA Court Report, paragraph 81.

⁴ See in particular Regulation 57/2009.

⁵ Procedural and Substantive Rules in the Field of State Aid, adopted and issued by the Authority on 19 January 1994, published in OJ 1994 L 231, as amended by Decision 313/06/COL (“State Aid Guidelines”).

⁶ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, OJ L 318, 17.11.2006, p. 17 (“Transparency Directive”). Incorporated at point 1a of Annex XV to the EEA Agreement.

measures, notably on 11 November 2011 (Event No. 713194), 1 June 2012 (Event No. 639998) and 27 May 2013 (Event No. 673674), as well as in various meetings.

- (5) A number of changes to HFF's public service mission were enacted on 18 June 2012, when the Icelandic parliament passed Act no. 84/2012 amending the Housing Act no. 44/1998 (with subsequent amendments). In their letter of 27 May 2014 (Event No. 709426), the Icelandic authorities informed the Authority of intended further changes to HFF's public service mission.
- (6) Act no. 84/2012 contains in particular the following measures:
- (7) *Limitation of the general loans system for residential housing:* The grant of loans to finance the purchase, construction or renovation of residential housing is now limited to individuals. That means that HFF will no longer offer loans for construction companies to finance the purchase, construction or renovation of residential housing. In addition, this loan category will be subject to a cost limitation regarding the eligible dwelling in the form of a maximum allowed loan amount and a minimum loan-to-value ratio.⁷ The maximum allowed loan amount was initially set at ISK 20 million and will be increased to ISK 24 million. The minimum loan-to-value ratio was initially set at 40% and will be raised to 60%. This will result in the future in a maximum value cap of ISK 40 million, above which dwellings are no longer eligible for HFF loans. This cost limitation is the object of a regular review, the criteria of which are the possibilities available to the general public for financing home purchases, i.e. whether the banks are offering sustainable mortgage loans, wage developments and economic forecasts. The objective of the mechanism is to ensure stability and assistance to the average resident of Iceland in buying a property on manageable terms while at the same time gradually withdrawing HFF lending in order not to hinder the entry of other mortgage providers into the market, i.e. to ensure that banks are able to participate in the market and expand their market shares. Act no. 84/2012 foresees a review by the Ministry every two years, with the first review taking place in 2014. The Icelandic authorities have now committed to changing this mechanism to allow for a yearly review involving an independent institution (e.g. Statistics Iceland). The developments in the property market will thus be regularly assessed to evaluate if, and to what extent, a market failure still exists. Furthermore, it is stated in the explanatory notes to the Act that the review mechanism is introduced in order to comply with the state aid rules, which should be taken into account when the review is made.
- (8) *Limitation of loans in the field of rental housing:* HFF will no longer issue loans to rental companies for the general purchase or construction of rental housing. Instead, this loan category will be limited to non-profit companies and municipalities in areas with a lack of affordable rental housing that will offer affordable rental housing, subject to restrictions in particular on size and building cost, dividend payments as well as rent regulation. In addition, loans for rental housing for certain socially disadvantaged groups (nursing homes for the elderly, students, disabled or people with low income) can be granted at subsidised interest rate.
- (9) *Accounting and supervision:* Act no. 84/2012 also contains provisions that make the operation of HFF subject to accounting and supervision rules similar to financial undertakings operating according to Act no. 161/2002 on Financial Undertakings. These

⁷ The calculation is based on the taxation value of the property. In addition, the legislation was amended so to ensure that HFF may only finance one dwelling per individual, subject to certain limited exceptions. Furthermore, loans from HFF may not exceed 80% of the value of the property. Under the previous legislation, HFF was allowed to provide loans of up to 90% loan-to-value.

include provisions on the eligibility of board member and the managing director; annual accounts, auditing and consolidated accounts; participation of board members in handling issues; and more reporting to the Icelandic Financial Supervisory Authority.

- (10) In addition to these measures, the Icelandic authorities have committed to the following:
- (11) HFF will not engage in any economic activities other than the provision of SGEI as set out in the (amended) Housing Act No. 44/1998. There is thus no obligation to separate HFF's accounts in line with the Transparency Directive.
- (12) The Icelandic National Audit Office will be entrusted with the task of a regular cost analysis regarding the operation of HFF. The aim of this analysis is to ensure that HFF is appropriately compensated for the performance of the SGEI entrusted to it and that there will be no overcompensation, in particular with regards to costs that might result from inefficiency on the part of HFF.
- (13) HFF loans are available to all residents of Iceland, irrespective of their nationality. The Icelandic housing policy does not discriminate against citizens from other EEA States.
- (14) Finally, the Icelandic authorities informed the Authority of the proposals of the Housing Policy Committee dated 6 May 2014 on a new system for the financing of mortgage loans in Iceland. The proposals foresee in particular that HFF's activities should be replaced by commercially-operating special housing finance companies on the one hand, and a SGEI institution to be created on the other.
- (15) Pursuant to Article 19(1) of Part II of Protocol 3, the Authority shall, where the EFTA State concerned accepts the proposed, record that finding and inform the EFTA State thereof. The EFTA State shall be bound by its acceptance to implement the appropriate measures.
- (16) The Authority notes that in the absence of specific EEA rules defining the scope for the existence of an SGEI, EFTA states have a wide margin of discretion in defining a given service as an SGEI and in granting compensation to the service provider. The Authority's competence in this respect is limited to verifying whether the EFTA State has made a manifest error when defining the service as an SGEI.⁸ It is against this standard that the Authority will assess the measures proposed by Iceland in acceptance of the appropriate measures.
- (17) Regarding the general loans system for residential housing, the Authority notes that the cost limitation for eligible dwellings as proposed by the Icelandic authorities results in the following proportions of Icelandic residential properties to be eligible for HFF loans:

	Capital area	Rural areas
Single-family	46.7%	98.8%
Multi-family	98.5%	100%
Total residential	80.2%	99.1%
	Total Iceland: 86.9%	

⁸ See e.g. Case E-9/04, *The Bankers' and Securities' Dealers Association of Iceland v EFTA Surveillance Authority*, [2006] EFTA Court Report, paragraph 65.

- (18) The amended maximum value cap therefore leads to a better targeting of HFF's lending activity to the alleged market failure in more rural areas of Iceland. It has the effect of excluding the higher price segment of the housing market, in particular for single-family homes in the capital area, for which there is a growing offer of commercial mortgage loans from the market.
- (19) The Authority further considers that the situation on the Icelandic financial markets is evolving rapidly, in particular due to the impact of capital controls and the ongoing restructuring of the Icelandic commercial banks.⁹ The Authority considers that the introduction of an annual review of the maximum value cap further safeguards that HFF's activities comply with the entrusted SGEI mission of assisting an average citizen in financing of his or her own housing. The Authority notes positively that the review mechanism aims at taking into account the competitive situation on the Icelandic mortgage market, and that an independent institution will be charged with the review.
- (20) As regards the granting of HFF loans to rental companies, the Authority welcomes the conditions introduced by the Icelandic authorities, which now target these loans at the provision of rental housing with certain characteristics relating to the size, cost and rent of the properties, or in favour of certain socially disadvantaged groups. These limitations implement the appropriate measures proposed in the field of rental housing loans.
- (21) The Authority notes the clarification from the Icelandic authorities that the Icelandic housing policy does not discriminate against citizens from other EEA States.
- (22) The Authority also notes the improved supervision and audit procedures to which HFF will be subject, and in particular the commitment to carry out a regular cost analysis to ensure that HFF operates efficiently and that there is no overcompensation. Furthermore, the business plan submitted to the Authority shows that HFF will reduce its operating costs and improve its lending practices in order to limit future losses. In any event, given that HFF will only provide SGEI, its total costs are in principle eligible for SGEI compensation.
- (23) Finally, the Authority notes the commitment by the Icelandic authorities that HFF will not engage in any economic activities other than the provision of SGEI. As a result, HFF will not be required to operate separate accounts between SGEI and other commercial activities under the Transparency Directive.
- (24) Based on the above, the Authority finds that the Icelandic authorities have accepted the appropriate measures set out in Decision No. 247/11/COL and hereby records that finding. The Authority notes that pursuant to Article 19(1) of Part II of Protocol 3, Iceland is bound by its acceptance to fully implement the appropriate measures.
- (25) The Icelandic authorities are reminded of the Authority's obligation to keep all systems of existing aid under constant review, in cooperation with the EFTA State concerned.¹⁰ The Icelandic authorities should therefore provide the Authority with detailed information on any changes in the definition of public service entrusted to HFF, including with regards to the operation of the review mechanism.

⁹ See e.g. Decision No. 291/12/COL of 11 July 2012 on restructuring aid to Arion Bank, OJ L 144, 15.5.2014, p. 169; Decision No. 290/12/COL of 11 July 2012 on restructuring aid to Landsbankinn, OJ L 144, 15.5.2014, p. 121; and Decision No. 244/12/COL of 27 June 2012 on restructuring aid granted to Íslandsbanki, OJ L 144, 15.5.2014, p. 70.

¹⁰ Article 1(1) of Part I and Article 17(1) of Part II of Protocol 3.

HAS ADOPTED THIS DECISION:

Article 1

The EFTA Surveillance Authority records the Republic of Iceland's acceptance of the appropriate measures proposed by the Authority in its Decision No. 247/11/COL on the financing of the Icelandic Housing Financing Fund (*Íbúðalánasjóður*).

Article 2

There are no longer grounds for pursuing the case concerning the financing of the Icelandic Housing Financing Fund (*Íbúðalánasjóður*). Therefore, the case is closed.

Article 3

This Decision is addressed to the Republic of Iceland.

Article 4

Only the English version is authentic.

Done at Brussels, 16 July 2014

For the EFTA Surveillance Authority

Oda Helen Sletnes
President

Helga Jónsdóttir
College Member