Germany disputes the implications of new lending regulations

Builders and property buyers in Germany have found it harder to get a residential mortgage since March 2016. The reason is a new EU directive, which attributes a far lesser role to the value of the property to be mortgaged than previously. At the same time, there is a greater focus on the creditworthiness of the applicants. The implementation of this directive into German law has, in addition, created tremendous uncertainty on the part of many credit institutions. The German government has also deliberately waived the exemptions for renovation projects provided for in the EU directive. There is a controversial debate within the financial sector over the actual implications of the new rules and about the necessary changes to the law in the short term.

According to the new EU regulations, banks can no longer use the value of the property to be mortgaged as adequate basis for granting a loan. This is already to be seen critically since, unlike in several other European countries, the assessment of real-estate in credit granting procedures in Germany is highly conservative.

From now on the focus will be on the creditworthiness of the future borrower. According to the will of the German legislator, banks need to ensure that borrowers are more likely to fulfil their contractual obligations. Experts, however, believe that the legally formulated conditions for an adequate check of creditworthiness leave great scope for interpretation.

A further point of criticism relates to the wording stipulating that only the contractual borrower should repay the loan. This is particularly problematic for persons approaching, or already in, retirement. In their credit decisions the banks should not assume that heirs will continue to pay a mortgage and therefore must strongly orient themselves towards the borrower's probable residual lifespan.

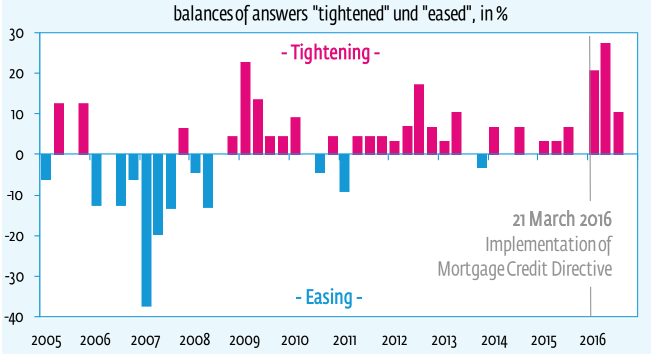
Since property value is not even supposed to play a decisive role in the case of renovation measures, older people are particularly heavily affected by the new regulations. However, families and young professionals are now finding it tougher to obtain a mortgage too.

Many banks – apparently the smaller and medium-sized banks – are showing caution in view of the new rules on borrowing. Insufficient previous assessment of creditworthiness means that they may end up paying their interest rate margin to borrowers. Moreover, borrowers can terminate a mortgage without previous notice and without paying any prepayment penalty. Proven misconduct on the part of lenders can be very expensive as a result.

According to quarterly bank surveys by the ECB, German credit institutes actually have clearly toughened up their lending conditions since March. Moreover, according to the German Bundesbank, the volume of newly issued residential mortgages was lower in most months since March than during the same period of the previous year. However, since the volume of new lending increased sharply in 2015, the recent, more unfavourable development probably also goes hand in hand with a "normalization" in the credit market. The actual implications of the new EU directive are not clearly discernible as a result.

Change of credit terms and conditions for private mortgages in Germany

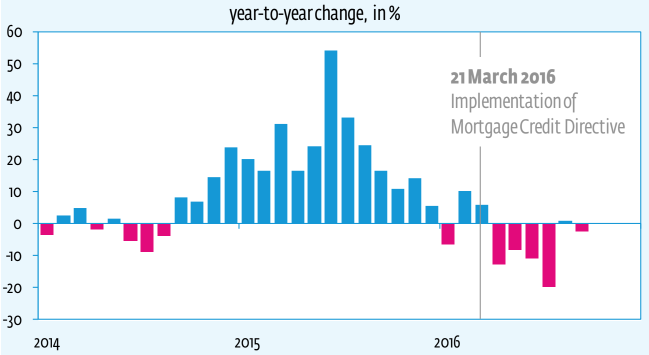
balances of answers "tightened" und "eased", in %



Source: ECB (bank lending survey).

Development of new private mortgage volume in Germany

year-to-year change, in %



Source: Deutsche Bundesbank.

Nevertheless both statistics suggest that the new regulations on borrowing have a negative influence. However, it is not yet clear whether this is merely a temporary effect, i.e. whether smaller banks will come to terms with the new regulations over time. Against this background, the larger banks have recently been quick to point out that their creditworthiness checks already met high standards. They only had to adapt their lending procedures slightly to comply with the new rules as a result and also see – just like the German National Consumer Advice Centre – far less need for legislative change.

In the meantime, several German Länder have launched an initiative to improve the current legal situation. The "probability of repayment" is to be clarified and future developments in salary are to be taken into account. Furthermore, exceptions shall be made for older mortgage applicants who wish to conduct building work to make their homes suitable for the elderly. However, there are certainly other changes needed such as, for example, ensuring that the borrower stipulated in the mortgage contract is not the only person "allowed" to repay his/her debts. The German government has at least declared its willingness to cooperate in order to remove the uncertainties for banks. One of the solutions discussed features a legal clarification whereby lenders should meet all of their obligations if they have complied with the interpretation of financial supervision.

It remains to be seen how quickly banks will throw off their caution in granting mortgages. In all events, it is clear that the implementation of the new EU regulations has impeded the financing of several new-build, conversion and renovation projects in Germany, at least temporarily.

According to our assessment, the new legal framework to date has negatively impacted mainly projects on existing buildings with older owners. Older owners namely suffered a triple punishment: the value of their property no longer justified a mortgage per se, as a result their relatively low pensions compared to their previous earnings further reduced their creditworthiness, and their lower residual lifespan also posed an additional barrier to obtaining a mortgage. This could negatively impact the growing market for renovation measures for making homes suitable for the elderly. On the other hand, the speedy abolition of this new form of "age discrimination" is high on the political agenda. So the negative implications for the renovation market may ultimately be limited.

CONTACT

Mr. Ludwig Dorffmeister
Ifo Institute, Germany
dorffmeister@ifo.de
www.ifo.de