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DATE 24 January 2022

SUBJECT **Views of the German Federal Ministry of Finance on the ESRB's recommendation regarding medium-term vulnerabilities in the residential real estate sector in Germany (ESRB/2021/10)**

FILE NO **VII C 1 - WK 3721/15/10001 :005**

DOCUMENT NO **2021/1261373**

(Please quote file no. and document no. in your reply.)

Dear Mr. Mazzaferro,

Thank you for your letter of 9 December 2021 notifying me of the European Systemic Risk Board's (ESRB) recommendation regarding its assessment of medium-term vulnerabilities in the residential real estate sector in Germany. In particular, the recommendation identifies high growth rates for prices, overvaluation of residential real estate prices, and indications of easing of lending standards for newly granted housing loans as potential sources of systemic risks.

The German Financial Stability Committee (FSC) and its member institutions agree with the ESRB risk analysis in general. Residential real estate prices are rising and the volume of real estate credit has increased again compared to the previous year. Indebtedness of private households is tending to increase, from comparatively low levels. However, while the average maturities of new mortgage loans have expanded significantly, the average loan-to-value-ratio has decreased steadily since the outbreak of the coronavirus pandemic according to data in the financial stability review 2021 of the Deutsche Bundesbank.

Based on its risk assessment, the German FSC concluded in December 2021 that macroprudential policy should return to prevention mode. Further, on 12 January 2022, the Federal Financial Supervisory Authority (BaFin) announced a package of macroprudential measures, which was welcomed by the FSC. The package consists of three measures in total. First, in order to address the cyclical vulnerabilities in the financial system, the countercyclical capital

buffer rate will be raised to 0.75%. Second, a dedicated sectoral systemic risk buffer of 2.0% will apply to loans secured by residential real estate; this specifically addresses systemic risks stemming particularly from the residential real estate sector and not covered by the countercyclical capital buffer. Financial institutions will have to fulfil the additional buffer requirements as of 1 February 2023. Third, supervisors are going to intensify their communication with lending institutions in order to raise awareness to the importance of prudent lending standards. The latter is in line with an FSC communication of December 2021 calling on banks and insurers to be prudent when granting residential real estate loans and not to assume that current price increases will continue unabated in the future. The former means that the total amount borrowed relative to the market value of the purchased real estate (loan-to-value ratio (LTV)) should be assessed prudently when making lending decisions. Moreover, given the current low interest rate environment, lenders should place special emphasis on sustainable borrowers' debt service ability and on appropriate repayment rates, not least with a view to potential future remortgages. Finally, the German FSC and its member institutions regularly monitor the development of vulnerabilities and in particular lending standards, and further action will be taken as appropriate.

Furthermore, the new German government asked the FSC to assess the German macroprudential tool kit with regard to existing gaps, that need to be closed. In addition, the coalition agreement contains a commitment to create the legal basis for income-based instruments. As recommended by the German FSC and the ESRB, these new instruments will encompass limits on the debt-to-income (DTI) and the debt-service-to-income (DSTI) ratio. The necessary legislative initiative will start in the course of the coming months.

In addition, we are supporting the ESRB's work on monitoring and mitigating systemic risks to financial stability. The ongoing work on the national monitoring of vulnerabilities arising from newly issued residential real estate loans is continuously improving. The reporting of lending standards for new mortgage loans pursuant to a dedicated data regulation will start on 31 March 2023. The data will be helpful in assessing the development of commonly used metrics for lending standards for new loans (e.g. LTVs, DTIs, DSTIs).

Finally, let me point out that the new German government is setting the goal of building 400,000 new apartments per year (including 100,000 publicly supported apartments). This initiative could contribute to reducing the price pressure in the residential real estate market.

Yours sincerely,

