



# Home buyers are financing even more long-term

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## In focus: Home buyers are financing even more long-term

Mortgage loans in Germany have risen to EUR 1,240 bn (+29% since 2011). Demand for real estate has been boosted in recent years by the strong economy and falling interest rates. The latter has reduced the annual interest burden on households from EUR 53.7 bn to EUR 30.5 bn since 2003.

To account for the increased risk from real estate financing, macro-prudential supervisors decided at the end of May to activate the countercyclical capital buffer for the first time. The main risks cited were a decline in the price of real estate collateral and a rise in interest rates.

Germans have always preferred long-term financing for real estate. Since 2015, a strong preference for loans with long rate fixation periods has shifted further in the direction of fixed interest rates over 10 years, which now account for almost half of all new contracts.

## Bank lending and deposits of households in Q1 2019

Households took out an impressive EUR 8.8 bn in net new loans in Q1. YoY growth accelerated to 4.2%, marking the largest hike in this millennium. Mortgage lending was up by a remarkable EUR 8 bn qoq. At this pace, total new mortgage lending might reach EUR 55 bn in 2019. Consumer loans grew by a noteworthy EUR 2.6 bn qoq, the largest Q1 figure of all times.

The uncertainty around the economic outlook probably affected banks' risk assessment for long-term commitments. Banks tightened credit standards for mortgage loans for the first time in three years, leaving consumer loan standards unchanged. The number of declined loan applications rose further. Still, margins on average housing loans narrowed, thanks to competitive pressure.

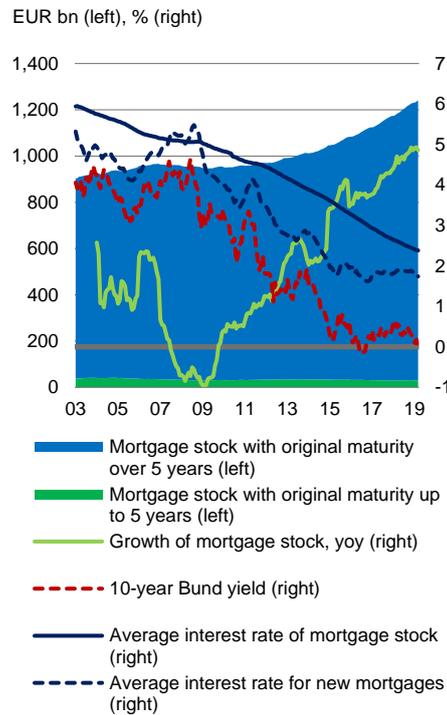
With a net EUR 21.8 bn, retail deposit inflows marked a record high for a Q1. If current growth of 5.7% yoy persists throughout the year, households might add up to EUR 150 bn to their bank accounts in 2019. In Q1, savings banks benefited the most from the deposit inflows.



## Home buyers are financing even more long-term

Mortgage stock is growing while interest rates are going down

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Sources: Deutsche Bundesbank, ECB, Deutsche Bank Research

### Increased risk from real estate lending?

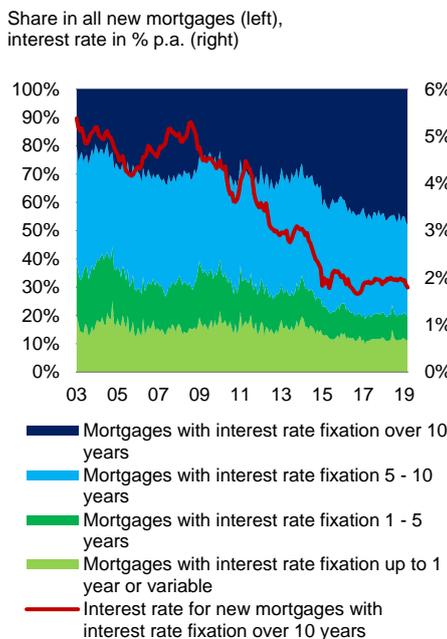
Private households<sup>1</sup> in Germany have outstanding mortgage loans of EUR 1,240 bn – an increase of 37% compared to 2003 and 29% compared to 2011. Lending shrank slightly during the financial crisis but households have since taken out more and more housing loans. Demand for real estate was boosted by the strong economy and falling interest rates. Real estate prices rose and credit volumes grew by 3-5% p.a. since 2015.

As a consequence, the German Financial Stability Committee at the end of May advised the Federal Financial Supervisory Authority (BaFin) to activate<sup>2</sup> the “countercyclical capital buffer”. Banks will be required to hold 0.25 pp more capital against their domestic risk-weighted assets by the third quarter of 2020 at the latest. The reasons cited, in addition to increased geopolitical uncertainty, explicitly included risks from real estate financing and the interest rate risk. In the event of a correction in property prices, which the Committee considers to be significantly overvalued, the loan collateral would lose value. Furthermore, a rise in interest rates would increase the interest burden on borrowers. The countercyclical capital buffer could then be used to cushion banks’ higher credit risk in such a scenario.

Private households in Germany are currently benefiting from very low interest costs. The average interest rate on all outstanding housing loans has fallen by more than half since 2003 to 2.4%. This significantly reduced households’ annual interest burden from EUR 53.7 bn to EUR 30.5 bn despite an increase in overall lending volumes.

Home buyers are financing ever more long-term

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Sources: ECB, Deutsche Bank Research

### Longer-term loan agreements: Interest rate risk declines for customers, increases for banks

Germans have always preferred long-term financing of real estate: 97.6% of all existing mortgage loans had a maturity of at least 5 years when the contract was signed. Short- and medium-term loans account for minimal shares of 0.4% and 2.1% respectively. The average interest rate for long-term loans is thus generally only 1 to 3 bp above the average for all mortgages.

As the loans are predominantly long-term, private households face only limited interest rate risk. The proportion of mortgages for which households will have to renegotiate rates within the next two years is now below 13%, which is even less than in 2015 when it was 16%. Loans with a remaining maturity of less than 2 years, some of which have to be refinanced afterwards, account for less than 7% (2015: 9%).

A look at new mortgage lending shows that German households’ preference for long-term fixed-rate mortgages of more than five years has grown since 2015. In addition, there has been a significant shift within this category towards rate fixation of more than 10 years, which now applies to almost half of new housing loans. These loans and their rate fixation are set to expire from 2025 at the earliest and – if they have not been fully repaid – will then probably be renegotiated. The risk of suddenly having to pay a higher interest due to a rise in mortgage rates remains, of course, but would only affect some households in the medium term.

<sup>1</sup> “Private households” according to the ECB interest rate statistics on which this report is based comprise employees and other individuals (as in the Bundesbank statistics, which form the basis for the regular report in the second part of this Monitor) as well as sole proprietorships and non-profit institutions serving households.

<sup>2</sup> Recommendation of the Financial Stability Committee of 27 May 2019 to increase the countercyclical capital buffer, AFS/2019/1. BaFin announced it would implement this recommendation.



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### Long-term mortgage loans cheaper than variable-rate loans

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Interest rates in % p.a. for new loans by rate fixation period

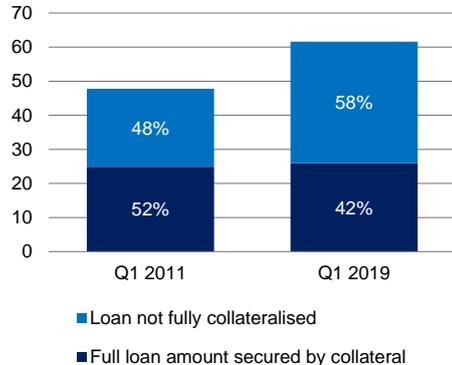


Sources: ECB, Deutsche Bank Research

### Fewer housing loans are fully collateralised

4

New housing loans in EUR bn



Sources: ECB, Deutsche Bank Research

## Interest on new housing loans

The growth in lending and the shift to even longer rate fixation periods went hand in hand with falling interest rates; the low and at times negative yield on 10-year Bunds also pushed long-term mortgage rates to record lows. Strong competition between banks is likely to be another reason for the generally low premium on contracts with long-term fixed rates. Since 2015, variable rates on residential mortgages have even been above long-term rates. Such an inverted yield curve has been seen before, especially in 2006-08.

New lending does not always involve additional loan volume. In fact, 20% of “new business” in 2018 came from the renegotiation of existing loans or follow-up financing. In 2015, this share was 24%; the longer rate fixation periods of recent years are also noticeable here. For renegotiated contracts, interest rates in 2018 were usually around 9 bp above the rates for “genuine” new business. This is probably because with renegotiations, unlike first-time loans, switching to competing providers is time-consuming and involves administrative costs.

## Less collateral for mortgage loans?

While new business flourishes, the proportion of fully secured loans is declining. In 2011, more than half of the new real estate loans were secured in full with a mortgage or financial assets; now this applies only to 42% of the new loans. Banks may be less inclined to demand full collateralisation given overall economic growth and the strength of the labour market. The remaining mortgage loans are also often backed by collateral but it is not clear to what extent. Since the interest rate for new, fully secured housing loans last year was only about 6 bp below the rate for all real estate loans, it can be assumed that many of the remaining 58% of the loans are also backed by high collateral. Nevertheless, the trend towards lower collateralisation is not conducive to financial stability, as the lender bears the risk of incurring losses if the borrower defaults and the collateral is subsequently realised. However, a significant price correction in the housing market – which the Financial Stability Committee sees as a risk – would also affect “fully collateralised loans”.

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## Home buyers are financing even more long-term

### Bank lending and household deposits

#### Loan volumes

Lending to households had an impressive start into 2019. Households took out a significant EUR 8.8 bn in net new loans, the highest Q1 figure since 2000. Yoy growth accelerated to 4.2%, marking the largest hike in this millennium, too.

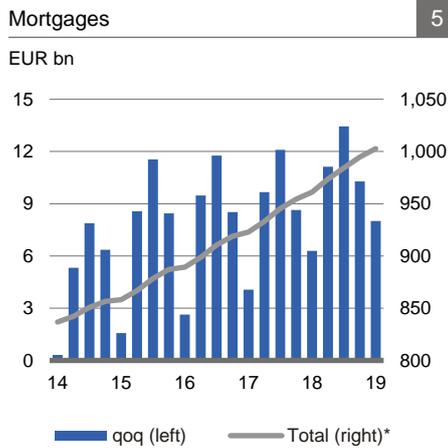
With EUR 8 bn qoq, the uptick in mortgage loans was remarkable. The yoy figure climbed to 4.5%. New mortgage lending by different banking groups was more or less similar: cooperative banks expanded their mortgage books by EUR 1.9 bn, savings banks by EUR 2.3 bn and credit banks by EUR 2.5 bn in Q1. If rates continue to hover around current levels, total new mortgage lending might reach EUR 55 bn in 2019. Interest rates at all-time lows and favourable household income dynamics have made homeownership increasingly attractive. Heightened demand has pushed up mortgage credit volumes since 2010 or so. Indirect impact of i) rising house prices due to subdued supply of new buildings and a lack of investment alternatives and ii) very low rates should not be underestimated though. Residential property prices in Germany surged by 50% on average in 2010-18 and almost doubled in large cities. To buy a property, households therefore need to take on more debt.<sup>3</sup> In addition, due to low rates, borrowing households can afford to take on more leverage. Both of these effects have led to a “mechanical” increase in mortgage volumes.

Consumer loans grew by a noteworthy EUR 2.6 bn qoq, the largest Q1 figure of all times. Yoy growth rose to 5.2%. If it continues at this pace, 2019 total might breach EUR 10 bn. With EUR 2.5 bn, credit banks (of which EUR 1.1 bn by foreign banks) accounted for almost the entire new lending in Q1. Loan volumes of cooperative banks and savings banks were virtually flat. A surge in employment has pushed the unemployment rate to historical lows (3.2% in Germany in Q1 compared with an EU average of 6.5%) and driven up the labour force participation (to 79%, 7 pp higher than the EU average). This has led to an expansion in the pool of creditworthy borrowers in recent years. Other loans fell by EUR 1.6 bn qoq but this was the usual seasonal decline.

14% of banks in the bank lending survey reported a rise in demand for mortgages. A large 24% of banks saw general level of interest rates as the main factor, while 14% cited benign housing market prospects. A net 6% of banks reported an upturn in consumer loan demand. Spending on durable goods such as cars and furniture and low interest rates were the main background factors as indicated by a net 13% and 6% of banks, respectively. Banks are optimistic for the current quarter, with 17% and 13% foreseeing a further rise in demand for mortgages and consumer loans, respectively.

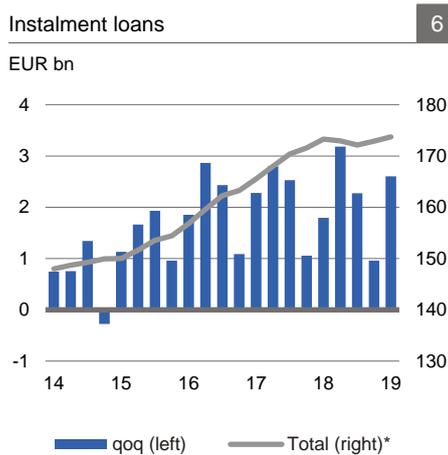
#### Credit standards for approving loan applications

In Q1, a net 7% of banks tightened credit standards for mortgage loans, the first tightening since mid-2016. 10% of banks saw a higher share of rejected applications for housing loans. Probably uncertainty around economic outlook affected banks' risk assessment for long-term commitments. Banks left credit standards for approving consumer loans unchanged. Competitive pressure and improved client creditworthiness prevented banks from tightening standards. However, as last quarter, 6% of banks reported an increased share of loan rejections. Looking forward, banks do not foresee a change in credit standards either for mortgages or for consumer loans.



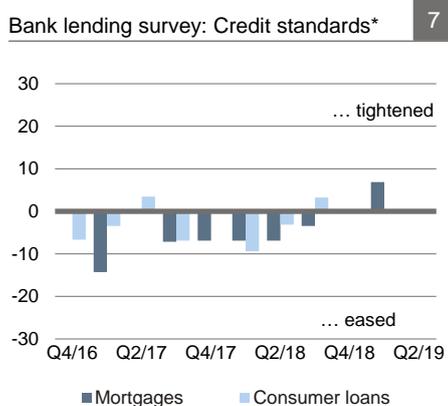
\*includes significant reclassification in Q3 18.

Source: Deutsche Bundesbank



\*includes significant reclassifications in Q2 & Q3 18.

Source: Deutsche Bundesbank



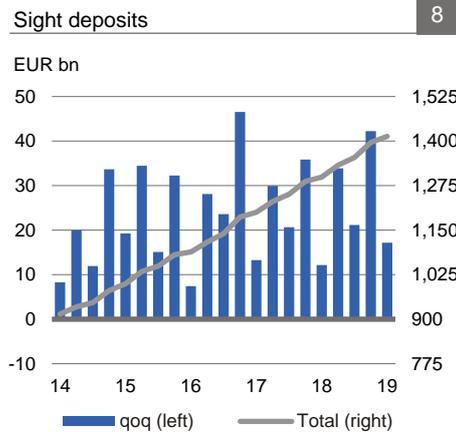
\*Q2/19 expected value

Source: Deutsche Bundesbank

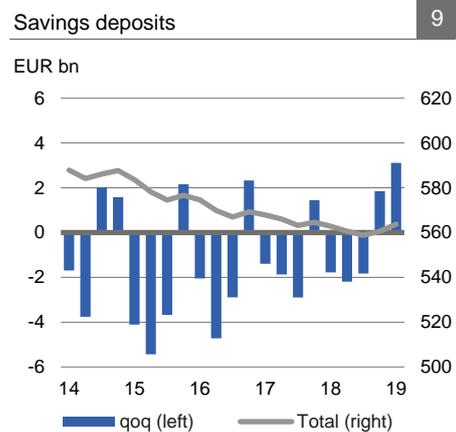
<sup>3</sup> See Bundesbank (2019). Household wealth and finances in Germany: Results of the 2017 survey.



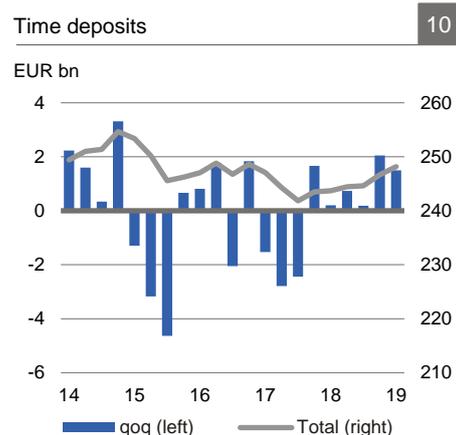
## Home buyers are financing even more long-term



Source: Deutsche Bundesbank



Source: Deutsche Bundesbank



Source: Deutsche Bundesbank

### Terms and conditions governing loan contracts

As indicated by a net 17% of banks, margins on average housing loans continued to narrow, and at a slightly accelerating pace. A huge 31% saw competitive pressure as the main driver. Margins for risky mortgages on the other hand widened at only 3% of banks, the first widening since 2016. On this front, banks' increased cost of funds and balance sheets constraints outweighed competitive pressure. Margins for consumer loans were virtually unchanged.

### Deposit volumes

Retail deposit inflows marked a record high for a Q1 with a net EUR 21.8 bn, in a typically weak quarter. The annual growth rate reached a remarkable 5.7%, the highest since 2010. If retail deposits continue to grow at this pace, households might add up to EUR 150 bn to their bank accounts in 2019. Commonly, banks aim to get the bulk of their market refinancing done at the start of the year. Indeed, German banks' net bond issuance was an impressive EUR 21 bn in Q1. Taken together with strong deposit inflows, banks may enjoy favourable liquidity and funding dynamics throughout 2019.

Sight deposits made up the lions' share of the uptick in Q1 (up by EUR 17 bn qoq and 8.8% yoy). Time deposits increased by EUR 1.5 bn qoq (1.8% yoy). Savings deposits surged strongly (EUR 3 bn qoq) and yoy growth turned positive (0.2%) for the first time since 2014. Once again the savings banks saw the largest sight deposit inflow, at EUR 7.8 bn qoq. Cooperative banks and credit banks recorded an increase of EUR 4 bn and EUR 4.9 bn, respectively, while sight deposits stagnated at foreign banks.

### Interest rates

In the first quarter, the average overnight deposit rate decreased minimally by 1 bp to 0.01% and remained below the 0.03% EMU average. The Eonia was -0.37% throughout the quarter. 10-year Bund yields dropped into negative territory in March (-0.07%). A noticeable rise in deposit rates is not on the horizon.

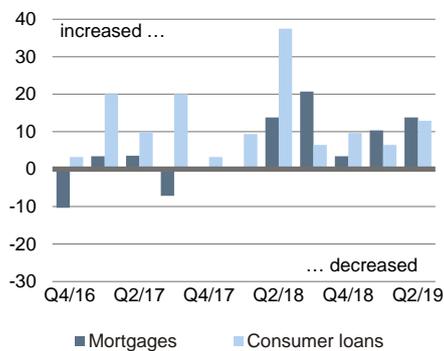
Following a sideways tendency during 2018, rates came down somewhat in the first quarter of 2019 in Germany. Hence, the ECB's strategy – in Germany at least – largely seems to work as banks offer ever more attractive rates just to avoid parking cash at prohibitive rates at the central bank. Rates for new mortgages fell by a significant 10 bp to 1.80% in Germany (EMU average: 2.06%). Consumer loan rates declined by 7 bp to 5.73%. EMU average moved the opposite way and increased by 20 bp to 6.18%.

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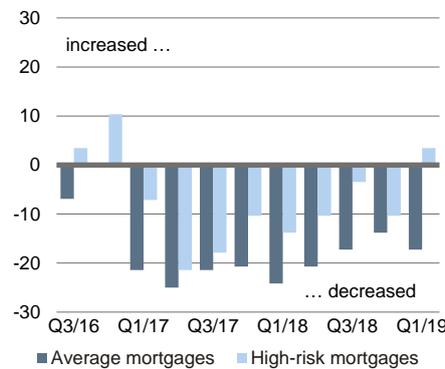
Bank lending survey: Credit demand\* 11



\*Q2/19 expected value

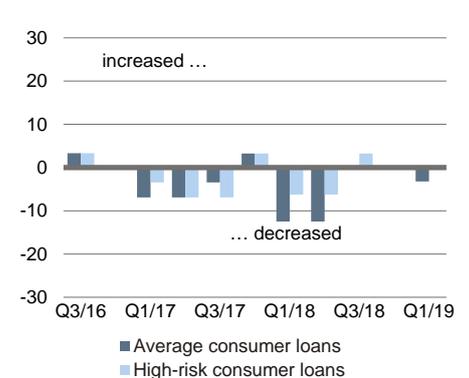
Source: Deutsche Bundesbank

Bank lending survey: Mortgage margins 12



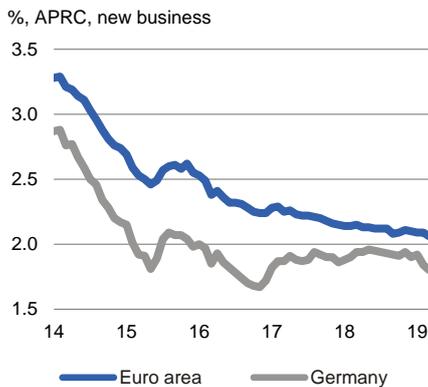
Source: Deutsche Bundesbank

Bank lending survey: Consumer credit margins 13



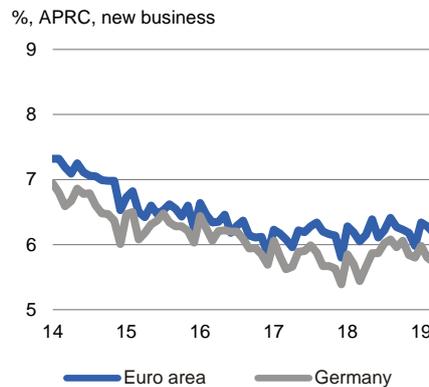
Source: Deutsche Bundesbank

Mortgage rates 14



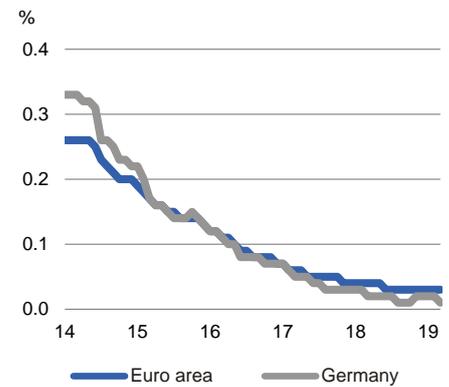
Source: ECB

Consumer credit rates 15



Source: ECB

Overnight deposit rates 16



Source: ECB

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