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New act sets limits for residential real estate loans

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The Austrian Financial Markets Authority has issued a new ordinance that contains strict limits on residential real estate loans for households in order to combat systemic risks from such loans.[1] The ordinance does not apply to commercial loans or the acquisition of (residential) real estate for investment purposes.

Background

The Financial Market Stability Board (FMSB), an advisory body consisting essentially of members nominated by the Federal Ministry of Finance, the Fiscal Advisory Council, the Financial Market Authority and various other institutions, has identified certain systemic risks from residential real estate funding. Between the end of 2010 and the end of 2021, real estate prices doubled in Austria, compared with slightly more than one third in Europe; annual mortgage lending growth averaged 4.2% in Austria (2.6% in Europe). While variable loan rates have dropped sharply in recent years, they still made up 40% of new businesses in 2021. A significant number of loans have debt service-to-net income ratios exceeding 40%; more than half of these outstanding balances were subject to loan-to-value ratios exceeding 90% or were not collateralised by any assets.

On the basis of these facts, the FMSB diagnosed that these systemic risks may prove critical to Austria's financial stability in times of crisis and suggested a number of measures to reduce the risk. The Financial Markets Authority has issued a new ordinance implementing these recommendations.

New limits

As of 1 August 2022, banks must observe the following limits when granting new residential real estate (RRE) loans to households:

- a maximum loan-to-value ratio (all RRE loans of the consumer compared to property value) of 90% with an exemption bucket of 20%;
- a maximum debt service-to-income ratio of 40% with an exemption bucket of 10%; and
- a maximum maturity of loans of 35 years with an exemption bucket of 5%.

The sum of all newly extended loans falling into one of the exemption buckets listed above may account for no more than 20% of the new funds provided during each half year period.

The ordinance does not require the banks to request a minimum-own-funds ratio; this issue is only indirectly addressed by the loan-to-value ratio. As borrowers not only have to pay 100% of the property value, but also ancillary cost, they will in effect need to cover 20% with their own funds.

In order to give banks some flexibility, all loans up to €50,000 are exempt from the new standards. These also do not count towards the exemption buckets. This exemption is intended to facilitate renovations and refurbishments, especially the switch from fossil fuels to renewable energy sources.

Comment

The existing Mortgage and Real Estate Loan Act already requires banks to review the consumer's ability to repay the loan before concluding the credit arrangement. However, that Act does not contain hard limits to the loan-to-value and/or debt service-to-income ratios or maturity limits.

The new ordinance will make it difficult for consumers to receive residential real estate loans from banks. For young families, it will be nearly impossible to finance their new home by such a loan without granting any additional security. Assuming a small apartment costs €500,000, plus 10% ancillary cost, the monthly rate for a 30-year loan would be approximately €1,600. The net income required to receive such a loan would be approximately €4,000 – an unlikely scenario at the beginning of one's career.

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Endnotes

(1) KIM-V, BGBl II Nr. 230/2022