RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 2 December 2021

on medium-term vulnerabilities in the residential real estate sector in Austria

(ESRB/2021/11)

(2022/C 122/02)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board ([1]), and in particular Article 3(2)(b) and (d) and Articles 16 and 18 thereof,

Having regard to Decision ESRB/2011/1 of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board ([2]), and in particular Article 18 thereof,

Whereas:

(1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.

(2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.

(3) Vulnerabilities relating to residential real estate (RRE) can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the RRE market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.

(4) As noted in recital 4 of Recommendation ESRB/2013/1 of the European Systemic Risk Board ([3]), the ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

([1]) OJ L 331, 15.12.2010, p. 1.
([2]) OJ C 58, 24.2.2011, p. 4.
([3]) Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

(5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council [4] and Regulation (EU) No 575/2013 of the European Parliament and of the Council [5], and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.

(6) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to RRE [6]. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, including Austria [7].

(7) In 2016, the main vulnerabilities identified in the RRE market in Austria were robust growth in RRE prices and mortgage credit and the risk of a further loosening in lending standards.

(8) Since 2018, the Austrian national authorities have used communication tools to ensure prudent lending standards, supported by reinforced macroprudential supervisory activities. In its follow-up report on countries that received warnings in 2016 on medium-term vulnerabilities in the RRE sector [8], the ESRB acknowledged that the measures introduced by the Austrian national authorities may efficiently address the predominantly emerging vulnerabilities. However, the ESRB also noted that the Austrian national authorities were given powers to introduce legally binding borrower-based measures in 2017 that could be exercised if the emerging vulnerabilities accelerated.

(9) The ESRB has recently concluded a systematic and forward-looking European Economic Area-wide assessment of vulnerabilities relating to RRE. In this context, the ESRB has identified certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.

(10) The outbreak of the COVID-19 pandemic in 2020 and the related crisis have not led to a cyclical decline in housing markets. Rather, following a period of gradual growth, and amidst the low interest rate environment, real house price and lending growth have accelerated further in several countries, largely outpacing the growth in household income. In order to mitigate the impact of the pandemic and the resulting economic uncertainty, various measures and policies, such as moratoria and public guarantees, have been implemented. In this broad policy context, previously scheduled macroprudential measures have been temporarily relaxed or their activation delayed in some countries. The currently observed improvement in the economic situation allows for an adjustment of macroprudential policy in those countries in which RRE-related vulnerabilities have continued to build up.

(11) As regards Austria, this recent assessment has revealed that following a period of moderate growth, real house price growth has accelerated, outpacing the growth in real disposable income. In addition, lending to households has steadily increased. The ESRB assessment also shows that since September 2019, real house price growth has accelerated in the first quarter of 2021, outpacing growth in real disposable income over the same period. In line with these developments, according to the Oesterreichische Nationalbank's estimates, house price overvaluation

(4) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

(5) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

(6) See Vulnerabilities in the EU residential real estate sector, ESRB, November 2016, available on the ESRB website at www.esrb.europa.eu.

(7) Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

(8) See Follow-up report on countries that received ESRB warnings in 2016 on medium-term vulnerabilities in the residential real estate sector, ESRB, September 2019, available on the ESRB website at www.esrb.europa.eu.

further increased in the first quarter of 2021. Real growth of lending to households for house purchase has been growing steadily since 2019. A communication from Austria's Financial Market Stability Board in June 2021 ([9]) indicated that lending standards for mortgage loans in terms of loan-to-value (LTV) ratio and debt service-to-income (DSTI) ratio have recently continued to rise against the five-year average, and that the share of lending with elevated values of these ratios was substantial.

(12) The current policy mix is considered only partially appropriate and partially sufficient to address the increasing vulnerabilities. Moreover, Austria has not made further use of the capital-based measures to address existing vulnerabilities and foster financial stability. In addition, the vulnerabilities identified in the RRE sector in Austria have not been fully reflected in the risk weights for mortgage loans, as used by credit institutions applying the internal rating-based (IRB) approach to the calculation of capital requirements.

(13) In the light of these recent developments, the ESRB has concluded that activating legally binding borrower-based measures would increase the effectiveness of the measures that are already in place to properly address medium-term vulnerabilities in the RRE sector in Austria. Whenever or wherever such binding borrower-based measures are assessed as not sufficiently effective to address medium-term vulnerabilities, the implementation of capital-based measures, such as instruments aimed at increasing the IRB risk weights for RRE exposures, the sectoral systemic risk buffer or the countercyclical capital buffer should be considered. These measures would increase the resilience of the banking sector in Austria to risks that might have accumulated, such as the prevailing overvaluation of house prices and to some extent loose lending standards for mortgage loans provided in recent years,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A – Activation of legally binding borrower-based measures

It is recommended that the relevant authorities activate legally binding borrower-based measures in order to mitigate the vulnerabilities in the residential real estate sector in Austria as a source of risk to financial stability.

Recommendation B – Activation or tightening of capital-based measures

It is recommended that the relevant authorities activate or tighten capital-based measures in order to ensure the resilience of credit institutions authorised in Austria and complement borrower-based measures in mitigating the vulnerabilities in the residential real estate sector in Austria as a source of risk to financial stability whenever or wherever such binding borrower-based measures would be assessed as not sufficiently effective to address medium-term vulnerabilities.

SECTION 2

IMPLEMENTATION

1. Definitions

1. For the purposes of this Recommendation the following definitions apply:

   (a) 'relevant authorities' means the authorities entrusted with the activation of legally binding borrower-based measures or capital-based measures in Austria;

([9]) Press release on the 28th meeting of the Financial Market Stability Board, available on the FMSG website at https://www.fmsg.at/en/publications/press-releases/2021/28th-meeting.html.

(b) 'borrower-based measures' means macroprudential measures that target borrowers, including limits on the LTV ratio, the debt-to-income (DTI) ratio, the DSTI ratio, maturity, and amortisation requirements;

(c) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the value of the property at the moment of loan origination;

(d) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;

(e) 'debt service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;

(f) 'debt service' means the combined interest and principal repayment on a borrower's total debt over a given period;

(g) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination;

(h) 'amortisation requirements' means measures related to the repayment schedule of the loan;

(i) 'capital-based measures' means any own funds requirements imposed on a credit institution to prevent and/or mitigate systemic risk as defined in Article 2(c) of Regulation (EU) No 1092/2010, including, under Articles 124, 164 or 458 of Regulation (EU) No 575/2013 or Chapter 4 of Title VII of Directive (EU) 2013/36, such as the countercyclical capital buffer or the sectoral systemic risk buffer;

(j) 'credit institution' means a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013.

2. **Criteria for implementation**

1. The following criteria apply to the implementation of this Recommendation:

(a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A and Recommendation B;

(b) when activating legally binding borrower-based measures and/or capital-based measures, their calibration and phasing-in should take into account Austria's position in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;

(c) specific criteria for compliance with this Recommendation are set out in the Annex.

2. Addressees are requested to report to the European Parliament, the Council, the Commission and to the ESRB on the actions undertaken in response to this Recommendation, or adequately justify any inaction. The reports should as a minimum contain:

(a) information on the substance and timeline of the actions undertaken;

(b) an assessment of the vulnerabilities related to household indebtedness and lending standards for new mortgage loans, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, maturities, and amortisation profile with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/ 2016/14 of the European Systemic Risk Board [10], together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;

(c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

([10]) Recommendation ESRB/2016/14 of the European Systemic Risk Board of 31 October 2016 on closing real estate data gaps (OJ C 31, 31.1.2017, p.1).

3. **Timeline for the follow-up**

In accordance with Article 17(1) of Regulation (EU) No 1092/2010, the addressees must communicate to the European Parliament, the Council, the Commission and to the ESRB the actions undertaken in response to this Recommendation or substantiate any inaction. The addressees are requested to submit such communication in compliance with the following timelines:

1. *Recommendation A*

   (a) By 30 June 2023 and by 30 June 2025, the addressees of Recommendation A are requested to submit to the European Parliament, the Council, the Commission and to the ESRB a report on any actions taken with regard to activating legally binding borrower-based measures. Where there is more than one authority responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

2. *Recommendation B*

   By 30 June 2023 and by 30 June 2025, the addressees of Recommendation B are requested to submit to the European Parliament, the Council, the Commission and to the ESRB a report on any actions taken with regard to implementing capital-based measures. Where there is more than one authority responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

4. **Monitoring and assessment**

1. The ESRB Secretariat will:

   (a) assist the addressees, ensuring the coordination of reporting and the provision of relevant templates, and detailing where necessary the procedure and the timeline for the follow-up;

   (b) verify the follow-up by the addressees, provide assistance at their request, and submit follow-up reports to the General Board.

2. The General Board will assess the actions and justifications communicated by the addressees and, where appropriate, may decide that this Recommendation has not been followed and that an addressee has failed to provide adequate justification for its inaction.

Done at Frankfurt am Main, 2 December 2021.

The Head of the ESRB Secretariat,
on behalf of the General Board of the ESRB
Francesco MAZZAFERRO

ANNEX

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATION

Recommendation A - Activation of legally binding borrower-based measures

The following compliance criteria are applicable to Recommendation A.

1. When activating legally binding borrower-based measures, the addressees should seek to prevent a significant or increasing share of:
   (a) new mortgage loans secured by residential real estate (RRE) that could result in credit losses in the event of their default combined with a decrease in house prices;
   (b) borrowers taking out new mortgage loans who are at significant risk of not being able to repay or service their debt regularly without significantly reducing their consumption following adverse economic or financial conditions, an increase in the cost of servicing their debt or adverse developments in the RRE market.
2. The addressees should use one or several legally binding borrower-based measures to ensure the effectiveness of the measures in place and to minimise any potential for their circumvention or for unintended consequences that could reduce their effectiveness and possibly create risks in other areas, in particular by ensuring that the legally binding borrower-based measures are applicable to loans granted to all types of borrowers and by all types of lenders.
3. Prior to activating legally binding borrower-based measures, an assessment should be made of Austria's position in the economic and financial cycles, in order to determine the appropriate calibration and phasing-in of such measures.
4. Prior to activating legally binding borrower-based measures, and in order to determine the appropriate calibration and phasing-in of such measures, the addressees should take into account the choice and calibration of the borrower-based measures currently in place, thus ensuring higher effectiveness in mitigating the vulnerabilities identified in Austria.
5. After the activation of the legally binding borrower-based measures, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in Austria. This will depend on the choice of the borrower-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.
6. When activating or calibrating legally binding borrower-based measures, the addressees should take into account all loans which are to be serviced by households from their income, regardless of the form of the loans, i.e. treating loans to housing companies as household debt.

Recommendation B – Activation or tightening of capital-based measures

The following compliance criteria are applicable to Recommendation B.

1. When activating additional, or tightening existing capital-based measures, the addressees should seek to ensure the resilience of credit institutions authorised in Austria in the face of the potential materialisation of systemic risk related to RRE which could lead to direct and indirect credit losses stemming from mortgage loans or arising as a consequence of the decrease in consumption by households with housing loans.
2. Prior to activating additional, or tightening existing capital-based measures, an assessment should be made of Austria's position in the economic and financial cycles and the sufficiency of legally binding borrower-based measures, as activated in compliance with Recommendation A, in addressing the medium-term vulnerabilities in order to determine whether activating or tightening capital-based measures would be appropriate.
3. After the activation of additional capital-based measures or the tightening of existing ones, it may be necessary to tighten the measures further or to activate additional macroprudential measures to address the vulnerabilities identified in Austria. This will depend on the choice of the capital-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.