NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Measures in the area of prudent housing loans providing effective from 1st January 2020 (Review)

Introduction

The aim of this document is to provide a brief and comprehensive review of measures in the area of prudent housing loans providing.

The legal framework for these measures is based on Act No 90/2016 Coll. on housing loans and Decree of the NBS No 10/2016 of 13 December 2016 as amended by Decree of NBS No 7/2018 of 29 May 2018 and by Decree of NBS No 10/2019 of 17 December 2019 laying down the details of the assessment of the consumer's ability to repay housing loans.

These measures apply to all providers of housing loans, including both banks and non-bank financial firms.

The review is simplified and does not replace the full text of these legal provisions.

General principles

- **The main objective of the measures is to reduce risks related to strong growth of households' indebtedness for both consumers and creditors** and to mitigate potential imbalances in the financial market as well as in the real estate market.
- Creditors are required to verify the limits and conditions only when new loan is granted or when there is a significant increase of the existing loan.
- The measures **do not apply** to refinancing loans, provided that the outstanding amount is not increased **by more than €2,000 or 5%** (whichever is lower).
- These measures represent only minimum requirements to be applied when housing loans are provided.
- All exemptions, that allow given share of loans to breach the limits, are expressed as a percentage of new lending in the respective half a year. Within quarters the exemptions are slightly higher, not more than by 2 p.p. (for example 7% of loans instead of 5% of loans).

Limits on the loan-to-value ratio (LTV)

$$\text{LTV ratio} = \frac{\text{amount of debt}}{\text{collateral value}}$$

LTV ratio cannot exceed 90%.
Share of new loans with LTV between 80% and 90% cannot exceed 20 %.

Amount of debt - new loan + all other loans secured by the same real estate. In case that the loan is additionally secured by a financial deposit, the amount of debt may be reduced by the deposit value under certain conditions.

Collateral value - the value of the mortgaged real estate property. It is the lower of either the independently appraised value of the real estate or its purchase price. In addition, this value is reviewed by the creditor on the basis of its internal appraisal.

The aim of limits on the loan-to-value ratio

The main reason for imposing limits on loans with high LTV is the pursuit of healthy and sustainable development of the market of housing loans and reducing the risk of price imbalances in the property market.

High LTV can cause problems in case of a drop in property prices for both the consumer and the creditor. If the consumer fails to repay the loan, the property may not be sufficient for the repayment of the loan and the consumer is subject to enforcement proceedings. On the other hand, the lender suffers an increased loss as well.

In case of housing loans amounting to 100% of property value, the consumer buying the property is not required to use any own money. This reduces the incentive for responsible decisions about buying property. Subsequently, growing imbalance on the real estate market may occur and the risk of negative impact on consumers and creditors increases.

Limit for the indicator of the consumer's ability to repay the loan

$$\text{Indicator of the consumer's ability to repay} =$$

$$= \frac{\text{payments of all fin. liabilities (subject to the increase in interest rates)}}{\text{net income less the subsistence minimum}}$$

Indicator of the consumer's ability to repay cannot exceed 60% (with exceptions).

Period	The maximum share of new loans with the indicator of consumer´s ability to repay between 60% and 70%	The maximum share of new loans with the indicator of consumer´s ability to repay between 60% and 80%
1/1/2020 to 31/3/2020	No limit	15%
1/4/2020 to 30/6/2020	No limit	5%
From 1/7/2020	5%	-

Payments of all financial liabilities = installment of the new loan + installments of all existing loans + other expenses on consumer’s financial liabilities in a given month. It takes into account the potential increase in interest rates.

The methodology of calculating the impact an increase in interest rates on the amount of installments

- For new and existing loans with a residual maturity of more than 8 years, creditors are obliged to take into account that interest rates may increase in future. In addition to current loan installment, they must therefore calculate the installment in case of an interest rate increase of 2 percentage points (with a ceiling of 6%), assuming maturity of 30 years. If this installment is higher than the original one, it must be used in calculating the indicator. For this calculation it is also necessary to adequately take into account the possible reduction of consumer's income in the event of retirement.
- For interest rate fixation over 10 years it is sufficient to perform the test assuming an increase of 1 p. p.
- In case of mortgages for young people the tax benefit is excluded.
- For loans with fixed interest rates over the whole maturity this test is not to be carried out.

Net revenue less the subsistence minimum = consumer’s net monthly income (i. e. net of tax and contributions), less the subsistence minimum for the consumer, his/her spouse and children in accordance with Act no. 601/2003 Coll. on the subsistence minimum. The consumer’s income must be documented and verified by the creditor from independent internal or external sources.

Aim of the limit for the indicator of the consumer's ability to repay the loan

The aim of the limit is to ensure that consumers have a sufficient financial buffer in their income as a reserve for contingencies. This decreases the risk of loan default in the case of a deterioration of economic conditions. Consumer’s net income is therefore first reduced by the subsistence minimum for the consumer, his/her spouse and children. 60% of the rest of the consumer's income can be used for the repayment of financial liabilities (subject to a potential increase in interest rates), so the reserve is 40%.

Example

Married couple with two children, with a total net income of €1,400 applies for a housing loan at an interest rate of 1.0% and maturity of 30 years.

Net income of this household	€ 1,400.00	
Subsistence minimum for this household	€ - 548.76	(valid from 1/7/2019 to 30/6/2020)
Difference between income and subsistence minimum	€ 851.24	
Reserve requirement (40% of this difference)	€ - 340.50	
Maximum loan repayment	€ 510.74	

Hence, the creditor may provide loan where the payment does not exceed the amount of €510.74, even in case of an increase in the interest rate by 2 percentage points (i.e. to 3.0%). The maximum amount of loan that can be granted in this case is €121,143 with an actual installment of €389.64.

Limit on debt-to-income ratio (DTI)

$$\text{Debt to income ratio} = \frac{\text{total debt}}{\text{annual net income}}$$

The maximum share of new loans for which the debt-to-income ratio exceeds 8 will be gradually reduced to 5% + 5% (if additional conditions are met)*.

* **Additional conditions:** Housing loans provided to customers aged up to 35 with income not exceeding 1,3 times the average wage and DTI for these loans does not exceed 9.

Total Debt = Loan provided + all other existing loans except for loans repaid by the loan provided. Existing credit cards and allowed overdrafts on current accounts are also included, with the drawn portion being counted in full, while only 20% of the undrawn portion of the credit line is included.

Aim of the limit for the debt-to-income ratio

The aim is to mitigate the risks associated with the rapid growth of household indebtedness. The indebtedness is growing in the low interest rates environment at an excessive pace and it is not sustainable in the longer term. Households with too high debt compared to their income may have serious problems with repaying these loans later. And if there are many such cases, serious problems can affect the financial sector and the domestic economy as a whole.

Limits on maximum maturity and requirements for regular repayment

Loan category	Limit	Additional condition
Housing loans secured by real estate	30 years	More than 30 years: 10%
Housing loans provided by building societies not secured by real estate	30 years	From 20 to 30 years: 20% From 25 to 30 years: 10%
Other loans	8 years	

Creditors cannot provide housing loans where the credit agreement allows (partially) deferred payment of the interest or principal, gradually increasing instalments, temporarily reduced interest payments, or instalments at frequencies of less than once a month.

This condition does not apply to the postponed payments or temporary reduced installments if the consumer during the loan repayment gets into unexpected financial difficulties. In addition, this requirement may not be met in certain cases stipulated by the law (reduced interest rate on mortgages for young people, reduced payments in case of the birth of a child), in case of standard changes of installments due to interest rate refixation and in cases not related to a very long period.

The aim of limits on maximum maturity and requirements for regular repayment
These measures aim to ensure that the maturity is in line with character of the loan and also that these loans are repaid regularly. This will, inter alia, mitigate the risk of rising household indebtedness.

Requirements for a prudent approach to lending through intermediaries

The creditor is required to independently monitor the loans provided through financial intermediaries and to compare their credit risk to the other loans. If a significantly higher credit risk is identified, creditor is obliged to immediately take the necessary measures to reduce this risk.