

Press release

Berlin / Frankfurt am Main, April 24, 2023

Pfandbrief banks master difficult market setting

- **Considerable increase in Pfandbrief sales**
- **Decline in new business in real estate financing**
- **Appeal: review impact of regulation and adjust where necessary**

The credit institutions which together make up the Association of German Pfandbrief Banks (vdp) coped well with the challenging market setting in the 2022 financial year. Whereas Pfandbrief business saw a positive development throughout the year, real estate financing business recorded declines in the second half-year in the wake of the general trend reversal in the market.

“The Pfandbrief and its issuers have mastered the numerous current stress factors including the recent turmoil in the financial markets well so far. With that, our member institutions have again shown that they are crisis-resistant and continue to act in a risk-conscious manner,” commented vdp President Dr Georg Reutter at the Association’s annual press conference in Frankfurt today. “Once again the Pfandbrief has proven its reliability as a long-term refinancing instrument that can be used at any time and its importance as an anchor of stability. The Pfandbrief market remains liquid, even in turbulent times.”

Dr Reutter emphasised that the real estate market and real estate financing in Germany could not escape the many stress factors that have coincided. In particular, he said, these include the sharp interest rate hikes, the surge in energy and material costs, the skilled labour shortage, difficult funding eligibility conditions for would-be builders and the general rise in the cost of living. “The combination of several negative factors has now initiated the long-awaited correction in property prices and is leading to substantially more subdued demand for credit.”

On the other hand, there are scarcely any signs that the banking turbulence in March is having an effect on European credit institutions or the German property market, Dr Reutter said, adding: “The central banks and governments in the US and Switzerland reacted quickly and decisively and calmed the situation.” At present, comparable scenarios are inconceivable for the institutions supervised by the European Central Bank (ECB), he continued, and made clear: “The first-ranking mortgage loan and the Pfandbrief had nothing to do with the recent turbulence, and it is unlikely they will trigger any future crises.”

- **Development of Pfandbrief business in 2022**

“Pfandbrief market in strong shape”

With an issuance volume of EUR 82.3 billion (previous year: EUR 64.7 billion), the Pfandbrief market last year achieved its highest level of sales since 2011. The driver of growth proved to be the Mortgage Pfandbrief, increasing its issuance volume to EUR 68.1 billion (previous year: EUR 46.4 billion), which was 46.8% up on the year before. Thus, the Mortgage Pfandbrief accounted for an 82.7% share in sales in 2022. The share accounted for by the Public Pfandbrief, which recorded an issuance volume of EUR 14.2 billion (previous year: EUR 18.3 billion), decreased to 17.3% as a result.

A rise in sales activity has also been recorded in the current year. Up to mid-April, large-volume Pfandbriefe with an aggregate volume of EUR 17.5 billion had already been issued – the highest volume of sales in this period for ten years. “The Pfandbrief market continues to present itself as crisis-resistant and in strong shape. Investor demand for Pfandbriefe is consistently high,” vdp Chief Executive Jens Tolckmitt emphasised. Tolckmitt pointed out that, as expected, the ECB's withdrawal from the market and its declining demand is being replaced by real-money investors, possibly even overcompensated, adding: “The market structures are finally returning to normal.”

Dynamic growth for sustainable Pfandbriefe

Sustainable Pfandbriefe recorded an extremely positive development in 2022, more than tripling the sales volume achieved one year earlier to reach EUR 9.4 billion (previous year: EUR 2.8 billion). As a result, the volume of Green and Social Pfandbriefe in circulation also increased markedly to EUR 17.7 billion (previous year: EUR 8.0 billion), which was more than double the figure year on year. The number of issuers of sustainable Pfandbriefe rose from eight to 12 in 2022. “ESG-related securities will continue to grow in importance. We expect to see more issuers of Green and Social Pfandbriefe going forward,” Tolckmitt said.

The total volume of Pfandbriefe outstanding at the end of 2022 amounted to EUR 393.5 billion (previous year: EUR 391.4 billion), thus continuing on the upward trajectory seen in the years before. The volume of Mortgage Pfandbriefe climbed to a new record high of EUR 283.4 billion (previous year: EUR 266.1 billion). By contrast, the volume of Public Pfandbriefe outstanding fell to EUR 110.1 billion (previous year: EUR 125.3 billion), partly attributable to the decrease in sales in 2022.

In contrast to the spreads of unsecured bonds and covered bonds of countries such as Italy and Spain, Pfandbrief spreads were again stable. In the volatile setting of the 2022 financial year, spread widenings were confined to the single-digit basis points range.

- **Development of real estate financing business in 2022**

Loan commitments fall, loan portfolio expands

The reticence shown by market players since last summer was reflected in a drop in new business for Pfandbrief banks for the year as a whole. Between January and December 2022 they issued real estate loan commitments totalling EUR 158.5 billion (previous year: EUR 178.0 billion). However, this was a development of two parts. In the first quarter, a record volume of EUR 49.0 billion was achieved, partly due to the effect of activity brought forward in anticipation of rising interest rates. The second quarter likewise showed growth compared with the corresponding period one year earlier. The second half-year, on the other hand, was marked by considerable declines in loan commitment activity.

In 2022, residential property loans accounted for a volume of EUR 98.2 billion (previous year: EUR 118.4 billion). This represented a decrease of 17.1% that was driven mainly by the abrupt rise in mortgage interest rates last year. Commercial property loans, on the other hand, totalled EUR 60.3 billion, thus confirming the level reached one year earlier (previous year: EUR 59.6 billion). With a volume of EUR 32.5 billion (previous year: EUR 33.6 billion), office properties were again the predominant commercial property class. These were followed by retail properties with a volume of EUR 15.0 billion (previous year: EUR 13.6 billion). The Pfandbrief banks' real estate financing portfolio expanded in 2022 to EUR 994.2 billion (previous year: EUR 957.5 billion – a growth of 3.8%).

Trend reversal in property prices

After more than a decade, there were signs from the third quarter of 2022 onwards that the increase in property prices in Germany was coming to an end. The trend broadened towards the end of the year. According to the vdp property price index, property prices rose again slightly by 0.8% in the final quarter of 2022 compared with the fourth quarter of 2021. However, prices fell by 2.0% compared with the third quarter of 2022.

“We are currently experiencing the long-awaited price correction phase. That said, the fundamental framework conditions continue to point to the attractiveness of the German property market,” said Dr Reutter. “For the current year 2023, we expect prices to contract further – across all property classes. However, as things stand today, we still do not expect an abrupt slump in property prices.” He went on to say that, given the increase in interest rates, demand for real estate and real estate financing will remain subdued. Structural factors with which the retail property market in particular has to contend will continue to have a burdening effect, Dr Reutter remarked, citing as an example the steadily growing market shares of online retailing.

- **Current regulatory issues**

Not the time for a knee-jerk expansion of regulation

After the Silicon Valley Bank and two other regional credit institutions in the US, followed by Credit Suisse, ran into difficulties last month, critics were quick to see in these events evidence of too little regulation of the banking sector and called for further tightening. The vdp does not share this view. “Now is not the time for a knee-jerk reaction by subjecting the entire banking sector to even more regulation,” said Tolckmitt. Rather, what is needed, first of all, is a thorough examination of the causes of the recent upheavals on the international financial markets. This, he commented, must be done in a targeted fashion. “After 15 years of continuous tightening and the completion of the main large-scale projects, it is time to review the effectiveness, consistency and relevance of the existing regulation and to adjust it where necessary,” Tolckmitt urged.

Macro-prudential instruments:

Capital buffers in urgent need of reassessment

Since February 1, 2023, the countercyclical capital buffer and the systemic risk buffer have applied to residential property financing. Since then, credit institutions are required to back financing they have provided with 0.75% and 2% more capital, respectively. According to Bundesbank calculations, these additional burdens total around EUR 22 billion, meaning that this amount of tied-up equity is not available to the banks for lending.

The vdp considers both capital buffers to be counter-productive, particularly the sectoral capital buffer. Tolckmitt explained: “We fail to comprehend both the amount of the systemic risk buffer and the time of its activation. By far the greatest part of private housing finance in Germany is extremely low-risk.” There was already a lack of convincing arguments when the buffers were announced in early 2022, Tolckmitt continued, as the structural data of residential property financing in Germany showed at the time. In addition, there is still clear excess demand for housing today, which presumably will now meet with considerable reductions in supply. Finally, the framework conditions have completely changed since the time the decision to introduce the buffers was made, Tolckmitt remarked. The dynamic growth in prices and credit volume, which were frequently cited as the reason for it, is over. “The systemic risk buffer for residential property financing lacks any fundamental justification,” he argued. The so urgently needed financing of residential property and rental housing is not only made considerably more difficult, but also more expensive, Tolckmitt said, and concluded: “We appeal emphatically to the Financial Stability Committee and to BaFin as the authority with which the decision rests to use the regular review of the appropriateness of the buffers for an unbiased reassessment.”

Basel III:

“Important that relief measures are incorporated into the legislative package”

In February of this year, the European Parliament presented its final report on the European Commission's legislative proposal on implementing the Basel III reform. The Council of the European Union had previously adopted its relevant common position in autumn 2022. This means that all negotiating positions are now available for the trilogue that has been ongoing since March and is expected to be concluded by the summer.

Compared with the original thoughts of the Basel Committee, the starting positions of the three EU institutions point to important, appropriate relief measures for the European banking industry that take into account the traditional characteristics of the European financing markets. “In particular, we welcome signs that low-risk residential property financing with low LTVs is to be treated differently. But at the same time, we criticise that these relief measures are limited in time and that objectively comparable commercial property loans are not to come under the privileged treatment,” Tolckmitt said. “We will not tire of emphasising that the Basel III reform does not do justice to the proven safety of real estate financing, which is already well regulated today. It is all the more important that at least the incipient relief measures are now incorporated into the final legislative package.”

Sustainable finance:

“Overambitious regulation reduces prospects of success”

Regulation of sustainable finance has been expanded again in the past months. With regard to the core element – the EU taxonomy – definitions have now been laid down for all six environmental objectives. In addition, the European Commission has published a catalogue of FAQs on the concrete implementation of the taxonomy criteria.

Moreover, the European Parliament and the Council of the European Union have agreed on the EU Green Bond Standard. The purpose of the relevant regulation is to regulate the use of the designation “EU Green Bond” for bonds that pursue environmentally sustainable goals. In addition, the trilogue negotiations on the Energy Performance of Buildings Directive (EPBD) will be getting underway in Brussels shortly. On the one hand, this directive envisages strict requirements regarding the energy efficiency of buildings. On the other, the proposal envisages mandatory Mortgage Portfolio Standards (MPS), which would require credit institutions to increase the total energy efficiency of the portfolio of buildings they are financing as well as to encourage their customers to renovate their property in accordance with the EU's climate goals.

The vdp supports in principle European climate policy and the Green Deal announced by the European Commission. The Pfandbrief banks also accept that they have, as finance providers, a special responsibility within the necessary transformation process, Tolckmitt pointed out. That said, however, he warned: “In its current form, sustainable

finance regulation is overambitious and oversized, which ultimately reduces its prospects of success.” Tolckmitt called for the polyphony of regulation as well as the excessive bureaucratic burden that both the banks and the real economy have to shoulder to finally be reduced. At the same time, he voiced support for creating efficient framework conditions to enable the financial sector to actually make a significant contribution to realising policymakers’ sustainability objectives. Tolckmitt also drew attention to the existence of conflicting objectives: “Sustainable finance regulation means higher housing construction costs. This makes the creation of housing that is significantly more affordable an even more remote goal.”

With regard to the EPBD, the vdp wants to see energy certificates standardised throughout Europe and national registers for these certificates established. Furthermore, in order to improve the energy efficiency of buildings, the vdp proposes state support measures for the real economy and the financial sector, such as state guarantees for the financing of renovation work. Tolckmitt went on to say how important it is that the MPS only aim for voluntary measures, as credit institutions are not the owners of the properties they finance, so that the influence they can bring to bear on the sustainable renovation of these properties is limited. He welcomed the final design of the EU Green Bond Standard as a voluntary framework. At the same time, however, Tolckmitt pointed out it would be difficult for the building sector to furnish the standardised proof of the EU taxonomy conformity of the financed properties as required by the Green Bond Standard, even in the medium term.

vdp membership development

Evangelische Bank and Raiffeisen-Landesbank Steiermark join the vdp

The vdp currently has 50 members. Together, they represent a market share of just under 97% of total Pfandbriefe outstanding. The most recent new members are Evangelische Bank and Raiffeisen-Landesbank Steiermark. An overview of all vdp member banks is available here:

<https://www.pfandbrief.de/site/de/vdp/verband/mitgliedschaft/mitglieder.html>

About the Association of German Pfandbrief Banks (vdp)

The Association of German Pfandbrief Banks is one of the five associations that make up the German Banking Industry Committee. It represents the sector’s most important providers of financing for residential and commercial property construction, governments and public-sector institutions.

Association of German Pfandbriefbanks

www.pfandbrief.de
www.pfandbrief.market

Press contacts

Carsten Dickhut
Tel.: +49 30 20915-320
e-mail: dickhut@pfandbrief.de

Horst Bertram
Tel.: +49 30 20915-380
e-mail: bertram@pfandbrief.de