How to Improve Housing Loans in Poland

On the 176th mBank–CASE Seminar concerning The Polish Economy 2023 and beyond: How to Improve Housing Loans?

The guests at the meeting, held on 30 March, were three experts on mortgage loans: Dariusz Filar, Ph.D., prof. em. at the University of Gdańsk; Andrzej Reich, leader of the Responsible Finance Club at the European Financial Congress; and Michał Polasik, Ph.D., professor at the Nicolaus Copernicus University in Turn, FINSEC Foundation. The seminar was chaired by Dr. Ewa Balcerowicz, head of the cyclical mBank-CASE Seminars.

In opening the Seminar, Dr. Ewa Balcerowicz outlined the direction of the discussion. "The remedy for the weaknesses in the mortgage loan market," she said, "is not to be found in isolated changes; it is essential that a new housing market model be established." She emphasised that it should embrace a more extensive choice of products, should be flexible and free of legal risk, and should better protect borrowers from risk. It is important that the state, as the housing market's regulator, ensure the proper conditions for its development, and that customers have access to the essential minimum of financial knowledge, especially concerning the risks associated with long-term housing loans.

Dariusz Filar, the first to take the floor, recalled that we currently have 2.4 million active housing loans in Poland, with a value close to 500 billion zlotys. However, borrowers do not constitute a homogenous group, because depending on the currency and year in which they took out the loan, their situations differ enormously. "The loans have led to a fragmentation of society into numerous groups, with different legal and financial standing, which had to and will still cause tensions and dissatisfaction, consequentially making the market unstable," he noted. He then presented the history of loans in Swiss francs in Poland, and explained how it came about that ultimately the state withdrew from intervening on the market. He recalled that initially (from 1996, when they first appeared), and for many a year to follow, franc loans guaranteed lower instalments than loans in Polish zlotys, but entailed risk in regard to the rate of interest (the possibility of the National Bank of Switzerland raising the base rate) and an even greater exchange-rate risk (the likelihood of the Swiss currency gaining in strength). Both these risks were trivialised by borrowers). Professor Filar pointed out that in 2005 the Polish Financial Supervision Authority (UKNF) publicly warned against taking out loans in foreign currencies. However, the political powers of the day took no decision towards restricting the ability to take out foreign-currency mortgages. The only instrument the UKNF could refer to in such a situation was "Recommendation S – concerning good practices in the managing of mortgage-backed credit exposure", published in 2006. However, the problem did not go away, and in addition, the party governing at the time issued an official document stating that "Recommendation S" was an attempt to restrict Poles' access to loans.

"Up until the end of 2012, there was no social frustration caused by franc loans, because their instalments were still lower than those of loans in Polish zlotys. However, in 2013-2014 the situation began to gradually flip, with loan instalments in francs starting to overtake zloty instalments," said Professor Filar. "And 15 January 2015 ('Black Thursday') delivered a real shock when the National Bank of Switzerland ended its policy of stabilising the franc's exchange rate at 1.2 CHF for 1 euro. Although in 2015, during the campaign for the presidential elections,

one of Andrzej Duda's promises was the regulation of Swiss franc loans, work on a statutory and systemic solution for the problem was delayed. Finally, in February 2017, the governing party announced that the state would not take measures in the matter of franc loans, and that borrowers should fight for their rights in the courts. The state's withdrawal from the problem resulted in a rash of law firms offering assistance to borrowers. Resolving the matter legally is currently the most common means of fighting the banks, while the ruling of the Court of Justice of the European Union has further increased interest in this form of solving the problem.

The second speaker, Andrzej Reich, described the market situation as "interesting and simultaneously worrying". He drew attention to the fact that households in Poland are not in general sufficiently familiar with long-term loans to anticipate their consequences for many years to follow. "In the event of a rise in interest rates, borrowers may find themselves unable to repay the loan, which can lead to very serious financial consequences," he said. Borrowers frequently treat housing loans the same as short-term loans; they are usually unaware of how such a loan works, particularly when taken out at a variable rate of interest.

Andrzej Reich believes that a serious threat today for the home loan market is legal risk, which could totally derail the banking sector. "The only way to be free of the legal risk would be to introduce a standard loan agreement," he argued. "In order to be sure of it being free of proscribed terms, the draft would have to be reviewed positively by state institutions: the Office of Competition and Consumer Protection, Financial Ombudsman, UKNF, Supreme Court and social organisations. The borrower's down payment should also play a significant role in long-term housing investments; it has many strengths on top of the one widely recognised, that is, that it provides additional loan security."

Much of his speech on the future model of the housing loan market focused on the issue of building relations between banks and their customers. For example, when granting loans, banks should take into account the customer's level of awareness, and apply tests similar to those used in the case of investors on the capital market. Financial institutions should adjust what they have to offer to the level of risk that customers can afford. The state, together with social and non-governmental organisations, should make a concerted effort to build up awareness and educate society so as to protect them from excessive financial risk.

The final speaker was Professor Michał Polasik, who presented a special instrument – that of the sustainable mortgage model. According to those who devised it (our speaker being among them), it constitutes a pertinent response to the current challenges triggered by the crisis on the housing loan market.

He discussed two fundamental causes behind the current crisis. The first of them is the traditional mortgage model, which – on the principle of financial mathematics – causes an automatic and unplanned acceleration of the loan's real repayment right at the beginning. The second is the complexity of the product, which results in the emergence of legal risk. A consequence of this is rising mortgage instalments and increasing legal uncertainty.

Professor Polasik and his team of experts are proposing a loan for which the initial payments would be lower than with an ordinary mortgage, at the price of capitalising the interest. "It's about making it possible for the customer not to pay the entire interest instalment; part of it

would be capitalised, meaning an increase in the size of the outstanding amount. By doing this, borrowers are able to cope with rises in interest rates. The real value of the loan is decreasing slightly the whole time, although the decrease in this value is less than in the equal instalment model," he said. "Applying the new loan model would not result in repayment of the loan being more expensive than the traditional model over the repayment period as a whole. The value of the instalments in real terms is similar. The annual percentage rate of charge is also essentially equal. It is an economically equivalent model in which there are no unintended benefits for one party or the other," he reasoned.

This does not mean that introducing a new type of loan will be easy. The model's developers believe that it will be necessary, among other things, to draw up a uniform loan agreement template, for example approved of statutorily, that would limit the so-called legal risk from the banks' perspective.

"The product is rather complicated in terms of calculation. We want to create a system in which we'll be able to issue a certificate for a specific contract, testifying to it being consistent with the algorithm. This is so that the customer would be certain that they are paying the amount they should be paying in each instalment, and that this is in their best interest," explained Michał Polasik. He also pointed out that educational measures would be necessary. The solution would be favourable to both parties. Banks would acquire the capacity to increase their range of loans, aligned with the phase of the economic cycle. There would be fewer defaulted loans, and legal certainty would be reinforced. Customers would also benefit – their ability to service their loan would be stronger, and the variability in the value of loan instalments would be limited.

In the section set aside for questions and comments, the audience asked, among other things, whether it was possible to escape the market's current crisis situation without further weakening the banking sector, and how to bring order to the situation on Poland's housing market, the primary market, and the rental market. Questions were also directed to M. Polasik regarding the details of the sustainable mortgage model proposed by his team of developers.

Link to the Seminar:

https://www.bankier.pl/tv/gospodarka/polska-gospodarka-2023-i-dalej-jak-naprawic-kredyt-mieszkaniowy-7678/