Ecology Building Society

Response to Basel Committee on Banking Supervision re Consultative Document on Revisions to the Standardised Approach for Credit Risk

Ecology Building Society (EBS) is a UK building society founded in 1981 and currently has around 9,000 members. Ecology exists to pursue lending in support of a sustainable society, through a sustainable housing stock and sustainable economic activity, as expressed in the Memorandum of the Society. Therefore the vast majority of it loans are made either for the purposes of substantial renovation and energy retrofit, or for the construction of highly energy-efficient new-build properties.

We fully endorse the comments provide by the Building Societies Association. We comment below only on those aspects of the consultation where we have particular concerns.

Our main concerns are set out below and are in response to questions 10, 11, 12, 13 and 21 of the consultation document:

1. Paragraph 37 relating to the qualifying criteria for residential real estate exposure which requires a *'Finished property: the property securing a mortgage must be fully completed'.*
    a. As a specialised lender, a large portion of our lending is for residential self-build projects where the borrowers intend to occupy the property on completion.
    b. Our interpretation of the current CRR, based on Article 125 1a)is that this category of lending may be treated as '*Exposures fully secured and completely secured by mortgages on residential property*' as it is the intention that the property *'shall be occupied…by the owner'*
    c. If the national discretion is not granted by our supervisor, then our capital requirement would increase by 28%, as these loans would now have to be included under the definition of '*Other Assets'* and weighted at 100%.
    d. Our review of a prospective borrower's suitability for a mortgage includes consideration of the ability to finish the project and meet their mortgage payments both during and after completion of the build.
    e. Our experience is that our self-build lending has not encountered a higher level of arrears or default. This is based on a similar approach being applied during more than 30 years of self-build lending.
    f. We suggest that mortgage loans assessed in this way should qualify for the residential real estate exposure. 100% weighting in all cases seems excessive.
    g. At the very least, the wording should be changed from *"fully completed*" to *"substantially complete and capable of habitation*" as many borrowers will occupy during the final stages of finishing off, thus reducing their outgoings.

2. Paragraphs 38 and 41 refer to the calculation and application of the Debt Service Coverage (DSC) ratio
    a. The data required to calculate this ratio has not been recorded on our system until recently. For historic cases we would need to manually review all our scanned mortgage files and enter the data on our system. For many of the records this will be a meaningless exercise as the income used for the borrowers will bear little resemblance to their current circumstances and the associated credit risk. The DSC ratio will only be relevant for assessing credit risk on recent mortgages, not seasoned ones, for example those over 5 years old.

b. If the DSC ratio is proposed, Paragraph 38 should be amended to indicate that for older seasoned exposures, especially where the DSC information is not available, the risk weighting in the table for *'Loans to individuals with [DSC < 35%]'* may be applied.

c. It may even be appropriate for a third category with lower risk weightings for these seasoned exposures and no reference to a DSC or income related ratio.

3. Paragraph 40 refers to the calculation of the Loan to Value (LTV) using the value at origination.
    a. As many of our exposures are on properties requiring work to be completed we would welcome further clarification for the calculation of the LTV.
        i. The proposals indicate the total loan amount in the calculation includes undrawn commitments. The valuation in this scenario should be based on the expected value on completion of the proposed works, which will have been assessed by an independent valuer reviewing the works and associated costs. If not, the LTV may exceed 100%, even though a small portion has been released which is less than the actual value.
        ii. Alternatively, the undrawn committed portion of the loan may be treated with the off balance sheet exposures. The LTV would be based on the actual loan amount outstanding and the latest independently assessed valuation.
    b. As most of our properties undergo modifications which substantially increase its value, we welcome the variation permitted to consider these revised values following an independent review with adequate appraisal. Whilst most of these appraisals will have involved an internal inspection of the property, other forms of documented inspection such as drive by valuation
    c. The proposed approach ignores the effect of house price movements over time. These adjustments can provide a good indicator of the current risk associated with the exposure, especially for older mortgages where the last independently assessed valuation is significantly less than the current market value of the property. We would welcome modifications to the proposals that allow some use of house price indices.
4. Paragraph 36 excludes exposures where the loan repayments are materially dependent on the income generated from the property.
    a. Our lending includes Buy to Let mortgages, housing cooperatives and housing associations which under the current regulations are weighted as exposures secured by mortgages on residential property.
    b. The proposals as they stand would increase our capital requirement by 10%.
    c. Our experience is that these loans do not carry a materially higher level of risk then the remainder of our residential portfolio.
    d. The majority of our buy to let mortgages are not held by professional landlords and in addition to rental income, the borrowers other income and outgoings also form part of the underwriting process
    e. Our lending to social housing organisations such as housing associations and housing cooperatives is assessed with a full review of the organisations financial status. This often provides affordable housing to members and tenants of these organisations

f. Whilst it may be appropriate for a slightly higher risk weighting to be applied where the income is derived from the property, a 100% weighting without consideration of the LTV seems excessive for our exposures.

27 March 2015

Contact: David Turner – 01535 650781
dturner@ecology.co.uk

www.ecology.co.uk