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Brussels,
27 March 2015

UEPC Response to Basel Committee Consultation on Standardised Approach for Credit Risk

The European Union of Developers and House Builders (UEPC) is the umbrella organisation for national federations of Developers and House Builders. UEPC is a European association representing more than 30,000 developers and house builders affiliated to the federations of 10 states (Germany, Belgium, Spain, France, Malta, Norway, The Netherlands, Poland, Romania and United Kingdom). The main aim of UEPC is to support and defend the interests of developers and house builders in Europe.

In response to the Basel Committee Consultation on Standardised Approach for Credit Risk published in December 2014, UEPC would like to submit its views. Our response is limited to Section 2.5 which deals with "Claims secured by real estate" as this is the area that will have most impact on our members.

Section 2.5 – Claims secured by real estate

We welcome the continued focus on capital: the lesson of the financial crisis was that the freezing of the credit markets had a significant negative impact upon the real economy and particularly the house-building sector.

However, since the financial crisis, regulators have overhauled the regulatory framework. Considerable capital now exists in the banking sector and, whilst, in the UK for example, the Bank of England stress tests conducted in the Q4 2014 identified some additional capital needs for the UK banking sector, these were relatively modest.

Furthermore, enhanced micro-prudential regulation, macro-prudential regulation and conduct regulation have all significantly toughened up both the operational procedures of banks to prevent them from building up excessive risk, but also hold additional capital already to absorb such risks.

We also note that the paper provides no evidence that the risk of lending secured on property has increased and therefore no justification of why the risk weights should change.

We believe that the changes in the risk weights suggested in the paper would probably require lenders to raise even more capital and this would have a number of implications for lenders and the house-building industry:

1) Higher capital charges particularly on lending to individuals with high loan-to-value (LTV) and/or debt service coverage (DSC) ratios as described for exposures secure on real estate, **will reduce the lending to this sector of the mortgage market.** We note that these higher risk weights will only apply to completed properties, and so lending to uncompleted properties will attract an even higher risk

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weight. It will therefore have a disproportionate effect on the first-time buyer market and new build sector, with a commensurate negative impact upon the house building market.

The current standardised approach for the residential real estate receives a risk weight of 35%. **UEPC believes a risk weight established at 35-40% for residential real estate is satisfactory.**

2) We have also struggled to find a clear definition of the term "completed property" and are concerned that there might be unintended consequences in circumstances such as:

a) Where individual properties are build complete but roads have not been topped or sewers adopted;
b) Where developers seek deposits on new build apartments and purchasers seek loans to finance them;
c) Where self-build properties are financed by loans.

3) It would appear **that some forms of property lending would be defined as specialist lending and would attract high-risk weights**. For example, it could be interpreted that buy-to-let (BTL) may be classified as specialised lending and therefore the risk weight for this sector could move from 35% to 120%. The change in risk weights would severely reduce the credit provided for BTL properties. This would, again, have a significant negative impact upon the house-building sector.

Likewise, although not specifically mentioned, **any change in the risk weight for lending to the social housing sector would have a negative impact upon the activities in this sector**.

We note that S21 of the Annexe refers to specialist lending *"to a SPE that was created specifically to finance and/or operate physical assets"* which would attract a higher risk weighting. We are concerned because it is common practice for land to be placed into a SPE for the purpose of funding development and such a measure would increase the cost of these developments.

Responses to specific questions under Section 2.5

Question 10: We would accept that LTV is a good predictor of loan default, however, we believe that this needs to be updated from time to time to reflect changes in house prices and loan values to avoid the perverse result that alternative mortgage providers will always be more competitive than existing providers. We are less convinced that DSC ratios are good predictors but, again, if these are to be used they should be subject to updates over time.

Question 11: We believe that LTV and DSC ratios should be updated over time but we wonder whether it is possible and/or practical for the DSC ratio to be updated.

Question 12: We have no views on this question.

Question 13: We would suggest that the Basel Committee consider using the age of a loan ("Vintage") as an alternative risk driver.

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