



GdW Statement

Consultative document

Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches

Basel Committee on Banking
Supervision

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Preamble

As the largest German umbrella organisation for the real estate industry, GdW Bundesverband deutscher Wohnungs- und Immobilienunternehmen e.V. (the Federal Association of German Housing and Real Estate Enterprises) represents some 3,000 municipal, cooperative, church, private sector and state and federally-owned real estate companies throughout Germany and at European level. It manages some 6 million rental apartments, inhabited by over 13 million people. GdW thus represents housing companies that manage almost 30 % of all rental apartments in Germany. Furthermore, property development business and project financing activities are also part of our purview, as are additional housing and real estate industry related services.

Within the German residential property market, owner-occupied housing constitutes the smaller portion, around 42 %. The remaining 58 % of all housing units are rental properties. Expressed in absolute numbers, the market consists of about 23 million rental apartments and almost 17 million owner-occupied units. Professional landlords hold around 40 % of the rental housing stock and thus manage more than 9 million rental apartments in Germany. Within this group, cooperatives, housing associations in which municipalities hold a majority interest, and private housing enterprises having the legal form of companies limited by shares occupy a key position as they manage almost 80 % of the professionally held stock.

The rulings of Basel III are of major significance to the housing and real estate industry. On the one hand, real estate industry investments are characterised by very high investment volumes. On the other hand, the share of outside (debt) capital required for financing is particularly high. The average share of equity capital used for real estate investments in Germany is generally just 15 % to 25 %, meaning that a substantial proportion of the investment costs have to be financed in the long-term with outside capital. The German real estate market is one of the most stable markets in the EU and worldwide.

The financing structure for housing development investments in Germany is characterised by long-term loans collateralised by liens on real estate or mortgage-backed loans. This has yielded highly positive experiences in the past, as this long-term culture grants the investors a high degree of planning reliability, while simultaneously providing tenants with a secure basis, as hikes in interest could otherwise lead to rental increases. This system has also proven to be particularly robust in the financial crisis.

In detail

According to the present framework agreement of the Basel Committee on Banking Supervision, banks have the choice between two basic methods for calculating the minimum capital requirement for credit risk, the **standard approach** and the **Internal Ratings-Based (IRB) approach**. The IRB approach must be expressly approved by the relevant banking supervisory authority. In applying the approach, banks are permitted to use their internal ratings systems for determining credit risk. This approach has now become standard practice at many banks that finance real estate development and has proven its worth in particular for loans collateralised by liens on real estate due to the low risk of default.

According to the consultative document, extensive restrictions are now to be placed on the area of application of the IRB approach. From now on, only the standard approach is to be used for so-called "low default" portfolios (banks and other financial institutions as well as large corporates or equities). Further, the use of the IRB approach (with estimates of LGD and CCF) will no longer be approved for corporates with an annual revenue of more than 200 million euros.

Even though the IRB approach is to remain in place for small company and retail exposures, lower limits in the form of so-called "exposure level floors" are to be applied to the model parameters PD, LGD and EAD/CCF to limit potential spread.

Furthermore, modifications are to be made to the LGD calculations for secured exposures in the basic IRB approach. When using the Advanced IRB approach, a long-term LGD component as well as a downturn component is to be estimated for the LGD. CCF estimates are to be greatly restricted.

In this context, we would like to point out that in its report to the European Commission on the results of the consultation (Future of the IRB Approach), the European Banking Authority does not challenge the IRB approach in principle. Rather, the following is proposed:

- to standardise the definition of model values and
- to limit the scope.

We do not see any necessity for tightening or placing extensive restrictions on the IRB approach. The introduction of floors for model parameters and a modification of the method used to estimate model parameters lead to a deterioration of financing terms, especially in the case of loans collateralised by liens on real estate. Past and, more importantly, present experience shows that "mortgage-backed loans" are exceptionally low-risk in Germany.

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