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Berlin, 2016, March 11

**ZIA's comments on the second consultative document
"Revisions to the Standardised Approach for credit risk"**

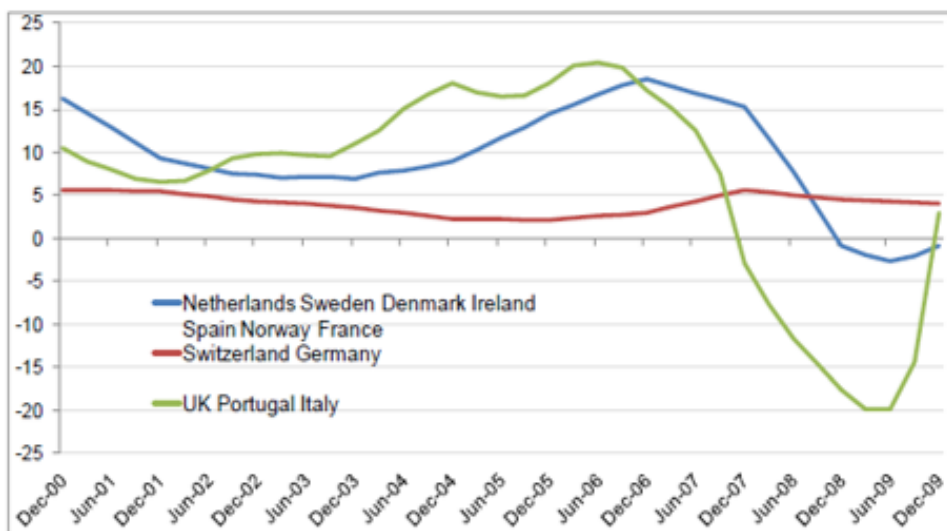
Dear Sir and Madam,

ZIA, the German Property Federation (Zentraler Immobilien Ausschuss e.V.), represents German real estate business in its entirety, including real estate financing institutions, real estate funds and real estate fund managers as well as the listed sector of the industry. ZIA speaks on behalf of individual member firms and more than 20 member associations, thus representing 37,000 branch members.

Real estate is by nature not only a long-term asset but also highly capital intensive. Access to capital is one of the major issues of a sector that contributes significantly to the stability of national economies as well as welfare of our societies and the well-being of all individuals. For these reasons and given its impact on real estate lending we consider the consultative document as highly important. We are grateful for the opportunity to make some remarks.

The Committee's analysis of the current treatment of secured real estate loans does not entirely reflect the situation in Germany. Even during and after the financial crises the default rate of secured mortgages was so small that the current calibration must be regarded as sufficiently prudent. The development of the house prices index for Germany shows a very low volatility.¹

¹ The IPD Solvency II Review, Informing a new regulatory framework for real estate.



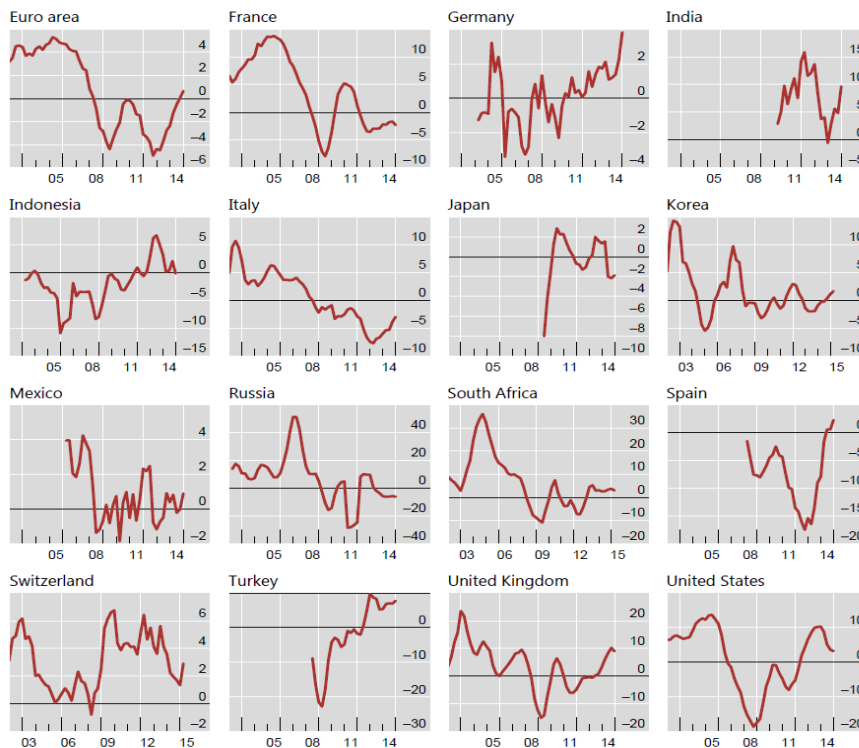
The graph shows the development of total returns (yields) of commercial real estate in Europe. Only in Switzerland and Germany no price bubble emerged and so a major correction, of the sort documented in the UK, Portugal, and Italy, was not required and did not happen. If differential responses of these magnitudes are observed even in the most extreme of economic circumstances, it would seem sensible to reflect these differences in the risk benchmarks that are deployed for determining capital requirements.

The banking department of the Bank for International Settlements itself published a survey showing the smaller volatility of house prices in Germany as compared to a number of other important national markets.² For instance the range of spotted negative and positive price developments in Germany compared to the United Kingdom is much tighter.

Even though the graphs shown below look almost comparable at first sight, it is remarkable, that their ordinates differ considerably. From this point of view we regret that according to the consultative document (page 34, paragraph 49 of the consultative document) the Committee allows national supervisory authorities to deviate from its proposal only by increasing risk weights.

We agree, that there is no “simple approach” to take into account all national characteristics (page 2 of the consultative document). Nevertheless, we see the possibility to allow national supervisory authorities to prescribe lower risk weights based on for instance the proof of a well-defined low volatility and a low loss rate (hard test).

² Bank for international Settlements, Residential property price developments – fourth quarter of 2014.



¹ Nominal residential property prices deflated by CPI.

In addition, we think that using “the loan-to-valuation (LTV) ratio as the main risk driver for risk weighting purposes” (page 2 of the consultative document), requires an alignment of valuation rules. To ensure a level playing field, the Committee should take into account for instance differing national approaches to the determination of mortgage lending values. Given those differing approaches a German LTV of 60 % may be comparable to an LTV of 80 % or 90 % in another country. This is caused by different valuation methods.

In many countries the mortgage lending value is derived from the current market value. In Germany the mortgage lending value (“Beleihungswert”) is calculated according to the German Pfandbrief Act (Pfandbriefgesetz) and the Regulation on the Determination of the Mortgage Lending Value (Beleihungswertermittlungsverordnung) when the refinancing is planned via a Pfandbrief. The mortgage lending value (Beleihungswert) differs considerably from the current market value. It is determined in a way that leads to a value that in all probability will never exceed the current market value of the asset, even if the market value falls to its possible low. But moreover this very conservative mortgage lending value (Beleihungswert) is multiplied by 0.6 to determine the value that will be taken into account as cover for Pfandbrief purposes (Lending Limit/Beleihungsgrenze).

And even if a bank plans to refinance loans without a Pfandbrief (and so the mortgage lending value would not be compulsory), the German valuation method standardised in the “Immobilienwertermittlungsverordnung” is also more conservative than most other valuation standards. The German “Ertragswertrichtlinie” – which supplements the Immobilienwertermittlungsverordnung – defines that only the sustainably achievable rent is to be used to calculate the value. In the discounted cash flow models the market rents and future developments are the basis for the calculation. A recent research conducted by Fitchratings of nearly 7,500 German commercial properties shows, that the market value, which

must be updated regularly, was on average 13.8 % higher than the original MLV at end1Q15, up from 12.4 % two years earlier. The study says:

“German Pfandbrief law requires collateral valuations to reflect long term property values, sustainable through property market and economic cycles. Regulation sets parameters for income and cost calculations used to determine the MLV when loans are originated.”

The ongoing stability of the German real estate market gives no indications that justify higher risk weights for exposures secured by real estate. The so-called “hard test” that the Federal Financial Supervisory Authority (BaFin) performs to fulfill Article 125 paragraph 3 and 4 and Article 199 paragraph 3 of CRR (EU Regulation No. 575/2013), reveals that loss rates stemming from lending collateralised by residential property are substantially lower than the maximum allowed rates. The loss rate in 2014 of 0.05 % for residential real estate loans was even exactly the same for commercial real estate loans.

With regard to **commercial real estate exposures** where the repayment is materially dependent on cash flows generated by the property the consultative paper proposes to double the risk weight (from 50 %) to 100 % when the LTV is 60 to 80 %. When the LTV is above 80 % the risk weight should be 130 %. Even when the LTV ratio is below 60 %, the risk weight would already increase to 80 %. In the context of a possible risk weight in the range of 80 to 130 % we have to emphasise the great economic importance of rented commercial properties. In Germany around 30 to 40 % of all commercial real estates – with a total market value of all commercial real estates over EUR 3 trillion – is held as an investment property and rented out. The commercial real estate investment industry provides a quasi-financial service to ordinary businesses, by providing premises on flexible terms that can accommodate changing needs. Without this, industry, small and growing businesses in particular, would face considerable challenges in securing appropriate premises. Businesses would be forced to build or buy commercial premises, and opportunities to scale up or down in response to changing circumstances and business needs would be far more limited. The commercial real estate industry thus plays a vital role in supporting and enhancing productivity in the SME economy.

To be able to provide its quasi-financial services to the wider economy (including SMEs), the commercial real estate investment industry needs a combination of equity and debt capital. This is particularly the case in regional and smaller markets – markets that are key to SME growth.

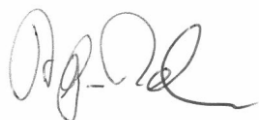
The relatively stable German real estate market gives no sign of warning that rented commercial real estate should be treated with such higher risk weights as compared to owner-occupied commercial properties. Moreover, the proposal would contradict EU and IMF proposals to strengthen investment.

Over 50 % of all loans in Germany are secured with properties. Such dramatically higher risk factors would be significant for this very important share of loans and would cause higher financing costs also for the real economy without gaining more financial stability.

Further, we note that we see an uncertainty with regard to a case of the land acquisition, development and construction of a property, where – in deviation from paragraph 61 – the sale is already certain. If the sale were uncertain, according to paragraph 61 a risk weight of 150 % would apply. If the sale is certain a risk weight lower than 150 % should apply. Nevertheless, we don't find any reflection on this in the consultative document.

We would be pleased if you could take these arguments into account in the ongoing process. If any further queries should arise, please do not hesitate to contact us.

With kind regards,



Dr. Stephan Rabe
Managing Director



Roland Franke
Head of financial market
regulation and taxes



Sabine Georgi
Head of real estate mar-
kets and capital markets