

31 July 2003

The Basel Committee on Banking Supervision
The Bank for international Settlements
CH-4002 Basel
Switzerland

Dear Sirs

Basel II Accord – impact on housing associations in England

The Federation represents nearly 1400 independent, not for profit housing providers. Our members include Registered Social Landlords (RSLs), Housing Associations, Cooperatives, Trusts and transfer organisations. They manage more than 1.8 million homes provided for affordable rent, Supported Housing and Low Cost Home Ownership as well as delivering a wide range of community and regeneration services.

Earlier this year the Federation, together with the Housing Corporation (the non-departmental government body that regulates English RSLs), commissioned a study by independent consultants on the likely impact of the Basel II Accord on the housing association sector. The results of that review confirmed that the implementation of the Accord ought to have no detrimental impact on the cost of borrowing for housing associations. The review did however indicate that there might be an indirect affect on how lenders view the sector. As a consequence of this, lenders' commitment to the sector could be significantly undermined. The Federation and the Housing Corporation have worked very hard, and to good effect, over the last 15 years to build up the housing association private finance market to its current level of £26bn. The prospect of the Basel II process disrupting the sector's access to private finance and its relationship with its lenders is of significant concern. There is little doubt that it would also concern the UK government if it were to put at risk its recent aspirations in its *Sustainable Communities Plan*.

The nature of the issue that causes us this concern centres on the application of Loss Given Default (LGD) in relation to the IRB Foundation approach. We particularly feel that that the proposed process does not satisfactorily recognise the unique characteristics of the English housing association sector. No account is taken of:

- The comfort afforded to lenders by the Housing Corporation in its regulatory role.
- The fact that no housing association has defaulted on its payment obligations.
- The fact that no lender has incurred financial loss on its loans.

The range currently set for LGD that will apply to our members is 35% to 45%. That compares to a minimum provision for residential mortgage lending (which has some general similarity with loans to housing associations which are usually secured against tenanted property) of 10%. We believe that it is anomalous that the IRB Foundation approach will discriminate in this way, particularly as it is supposed to provide for a smooth transition between the Standardised and IRB Advanced approaches. We believe that there can be no justification for imposing a minimum of 35% and would strongly urge you to consider exceptional treatment for the sector via a significant reduction to the minimum %.

The Federation and the Housing Corporation have been engaged in discussions for some months with the Council of Mortgage lenders (CML) which represents the UK lending community and the FSA who are the UK's financial regulator for Basel II purposes. During our discussions we have found a measure of agreement with the CML on this issue. The Federation and the Housing Corporation believe that there is a danger that transition from the Standardised Approach to the IRB Foundation approach will effectively become a barrier that could result in some lenders withdrawing from the sector. If that happened then there could certainly be a secondary impact on prices. At a time when the Federation and the Corporation are keen to attract more lenders to the market, we would want to do all that we can now to ensure that Basel II does not have the opposite effect.

We would appreciate your urgent consideration of our request for amendment to the existing proposals to address our concerns. We look forward to hearing from you – in the meantime please do not hesitate to contact me if you require any further information or clarification.

Yours sincerely

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