Build Europe
Response to EBA Consultation Paper
"*Draft Guidelines on ADC exposures to residential property under Article 126a of Regulation (EU) 575/2013*"

1. Introduction

Build Europe, in principle, welcomes the European Banking Authority's (EBA) efforts to enhance financial stability through risk management guidelines. However, we believe that the guidelines on substantial cash deposits, financing ensured in an equivalent manner, obligor-contributed equity, significant portion of total contracts, and the special framework for public housing and not-for-profit entities need adjustments. These changes are essential to balance risk management with practical financing needs and support the growth of Europe's housing sector, which is key to tackle the current housing affordability crisis.

While we understand that the EBA is focused on risk reduction, it is also important to consider the political need for new housing at affordable costs. From the perspective of European developers, ADC loans are not high-risk since the residential property business operates in a responsible and reliable manner. Additionally, many European countries already have mechanisms in place to ensure that loans are secure. Even in the event of failures, properties serve as security, and loans are disbursed in instalments. Therefore, while we recognise the EBA's concerns about risks, we would also invite them to consider both the political perspective and that of European developers.

2. Substantial cash deposits

The EBA's thresholds for cash deposits are at least 10% of the sale price for pre-sale contracts and at least three times the monthly rent for pre-lease contracts. While clear, these thresholds will be a burden for developers, especially for the smaller ones. **High deposit requirements will limit developers' ability to start new projects, reducing housing supply** and affecting the residential market.

To address this, we propose a flexible approach. A tiered system where deposit percentages vary based on project size, type, and regional market conditions would be more suitable. We also suggest considering alternatives like bank guarantees, insurance products, or phased financing to reduce the need for large cash deposits. Implementing these changes gradually would help developers adjust without disrupting the market.

3. Financing ensured in an equivalent manner

Article 126a allows Acquisition, Development, and Construction (ADC) exposures to receive a lower risk weight if financing is ensured in an equivalent manner, such as holding instalments paid in segregated accounts. However, this requirement can create financial and operational challenges for developers. **Keeping cash in these accounts reduces liquidity, especially for smaller developers, which is likely to delay projects and increase administrative work.**

To ensure flexibility, we propose including a broader range of financial instruments like bank guarantees, letters of credit, and insurance products as equivalents to cash deposits. Expanding the list of acceptable equivalents and implementing changes gradually will help developers and financial institutions adapt without significant disruptions.

4. Obligor-contributed equity

The EBA requires that the ratio of equity at risk should not be below 35% in order to apply the risk weight of 100% to ADC exposures, aligning with the guidelines under Article 126a's emphasis on substantial equity at risk. **However, requiring a 35% equity contribution from developers will be too high for them, particularly for smaller ones, as it is likely to limit their ability to secure financing and start new projects, negatively affecting the provision of housing supply**.

Equity contributions vary across countries and project types. We recommend that the EBA allow different equity contribution levels based on the specifics of each project. Recognising other financial commitments, such as subordinated debt, as equivalents to direct equity contributions would offer needed flexibility. Implementing these changes gradually would help developers adjust to the new requirements.

5. **Significant portion of total contracts**

Article 126a specifies that ADC exposures can be assigned a lower risk weight if a significant portion of contracts (at least 50%) are pre-sold or pre-leased, which clearly will be challenging for developers, especially smaller ones, as it limits their ability to secure financing and start new projects. To be practical, the number must be much lower.

Pre-sale and pre-lease practices vary widely. In some European countries, there is no significant pre-lease practise whatsoever. We suggest a flexible approach that recognises other financial commitments, like letters of intent or preliminary agreements, as valid equivalents to fully signed contracts. A tiered system, adjusting thresholds based on project specifics, would be more practical.

6. **Special framework for public housing and not-for-profit entities**

Supporting public and not-for-profit housing providers is important, as highlighted in Article 126a, which calls for tailored guidelines for these entities. However, **it is essential to ensure that private residential service providers in affordable housing are not unfairly disadvantaged**. Lower cash deposit thresholds and higher ratios for public/not-for-profit entities will discourage private investment in affordable housing projects, leading to higher costs.

Encouraging public-private partnerships (PPPs) is a good way to bring together the strengths of both sectors. Policies should support collaboration and ensure PPPs aren't unfairly burdened compared to public projects. Having the same rules for both public/not-for-profit and private affordable housing providers would prevent market distortions, ensure fair competition, and increase the supply of affordable housing.

7. Conclusion

Build Europe, in principle, welcomes the EBA's efforts to enhance financial stability through risk management. However, we believe the current guidelines need adjustments to balance risk management with practical financing needs. <u>It is crucial that EBA's guidelines do not increase administrative burdens for developers and do not negatively impact on their efforts to increase housing supply across the EU. Currently, the European housing affordability crisis excludes millions of citizens and families from access to decent housing at affordable costs, and introducing additional unbalanced financial rules risks making the crisis even more severe</u>. We hope that EBA will take into account our proposals to ensure the growth of EU's housing sector, in line with the current ambitions of the new European Commission.

We are available for the EBA and the future European Commissioner responsible for housing to discuss in detail the important issue of risk management of ADC loans and its impact for the European housing market. We are highly interested to act on the European challenge of providing affordable housing for all EU-citizens and at the same time work on an appropriate and reasonable level of risk management.