By email to:
CP16_22@bankofengland.co.uk

31 March 2023

Dear Bank of England Basel 3.1 implementation team,

BPF representation on CP16/22 – Implementation of the Basel 3.1 standards

The British Property Federation (BPF) represents the UK real estate sector, an industry that contributes more than £107bn to the economy and supports 2.3million jobs. Our members are invested in commercial and residential real estate in communities across the UK - revitalising our cities and shared spaces, re-imagining our town centres, and creating vibrant new places designed for the way we live today.

Some of our sector's main challenges and priorities mirror those of the wider economy and the communities we invest in: cutting carbon emissions, reimagining our town centres and increasing the supply of good quality homes. These challenges will require significant capital investment – and bank finance will be a crucial component in helping our sector to address these big challenges. We set out further background on these priority areas with the appendix.

The stability and security of our banking sector is crucial – for our sector, and the economy as a whole – and to that end, we are supportive of the introduction of a new prudent valuation measure for commercial real estate as well as broader proposals to ensure that sufficient capital is allocated against elements of risk in the financial system. However, the banking system is also a crucial source of capital for businesses (including property businesses) delivering important economic and social benefits. To that end, the rules must strike the right balance between protecting the banking system and supporting the real economy. To that end, risk weightings must be fair and appropriate.

We have engaged with both the Commercial Real Estate Finance Council of Europe ("CREFCE") and the Royal Institute of Chartered Surveyor's ("RICS") in considering questions 13 and 14 of this consultation – and we fully endorse their detailed responses. In addition, we have drawn out three important messages below:

1. **We support a new prudent valuation metric at a national or sectoral level** – given the importance of the 'loan to value' metric in determining the relative risk of the loan, we recognise the importance of using a long term sustainable value – and therefore support the introduction of a prudent valuation metric for real estate. We do not think it will be possible for this valuation to be carried out at an individual property level – not least because it would result in significant subjectivity in valuations. Rather, real estate should continue to be subject to normal market valuations - with a prudent valuation metric being applied as and when appropriate at a national or sectoral level.

2. **A much wider range of risk weightings is needed to reflect the range of risk associated with different real estate loans.** The proposed risk weightings for real estate lending are very high – with very little gradation in risk. For example, the risk weightings for regulatory commercial real estate which are materially dependent on cash flows from the property range from 100% to 110% - which does not reflect the range of possible risks in this sector (and assumes that a loan with a 10% and 80% loan to value would carry the same risk weighting). That may mean that businesses are unable to source appropriately priced finance for lower risk lending – which would inadvertently stymie the availability of finance for some important areas (such as energy

efficiency improvements, repurposing our high street, and creating new homes). Furthermore, some very high-risk loans may not be subject to appropriate capital allocations. In order to ensure that the risk weightings are correctly influencing lending behaviours and resulting in appropriate capital allocations, a much wider range of risk weightings should be introduced.

3. **Land acquisition, development and construction ("ADC") –** the proposals set out a category of real estate exposure class relating to land acquisition, development and construction – suggesting a minimum risk weighting of 150% for these loans. We are particularly concerned that the very wide scope of this exposure class will reduce lending to some of the priority areas set out in our appendix (decarbonisation, repurposing our high streets, and the supply of new homes) – even where a high risk weighting is not justified. We would support two exclusions put froward by CREFCE to mitigate this risk – namely:
    a) A carve out for Build to rent (BTR) from being automatically included within the higher 150% risk weighting band.
    b) In respect of decarbonisation and town centre regeneration – where construction or planning risk arises in the context of financing asset management strategies that reduce carbon, climate and wider obsolescence risk, the financing should remain subject to IPRE (income producing real estate) slotting rather than falling into HVCRE (high volatility commercial real estate) slotting.

We would be glad to arrange a meeting to discuss our response in more detail, if that would be helpful - please do not hesitate to get in touch for further information.

Yours sincerely

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Appendix 1: How the property sector is helping to overcome important social and economic challenges

1) A greener, decarbonised future – accelerating the net zero carbon transition

The UK has committed to achieving net zero by 2050. The property sector has a critical role to play in meeting this goal as around 25%[1] of all greenhouse gas emissions come from buildings. However, we can not build our way to net zero. 80% [2]of the property that will be around in 2050 has already been built, so it is essential that we work to improve the energy efficiency and sustainability or our existing homes and business premises. This will have the added benefit of reducing the cost of heating homes and businesses and making our country less reliant on fossil fuels.

In order to accelerate the transition, the government have introduced regulations to ensure that buildings with very low energy performance certificate ratings (EPC's) will be unable to let out their properties – and it is expected that from 2030, this will cover properties below EPC B. We are starting to see some data being made available on this milestone – with one agent estimating that 87%[3] of offices in the UK are rated EPC C or below. There is clearly a huge amount of investment needed to achieve our net zero targets – with a major risk of stranded assets if investment is not made. It is therefore crucial that the banking rules do not inadvertently stymie capital to these much needed retrofitting works.

2) Levelling up – thriving town centres across the UK

Our high streets have undergone a significant transition over the last decade or more – predominantly through the structural shift in retail moving to increasingly online platforms. This has left a challenging environment for many high streets, with high vacancy rates, and the need to find new uses for previous retail previses. We acknowledge that there is no silver bullet to addressing this changing environment on our high streets – with planning rules, the tax environment and joint efforts between public and private stakeholders all playing a role. Bank funding will be a key part of unlocking the changes we need to see on our high streets – and it is important that proposals will not act as a barrier to seeing our high streets thrive.

3) Housing – Developing a high quality rental sector (Build-to-Rent)

Long term investors in property have increasingly invested in residential property – there is a huge undersupply of residential property and the market is crying out for higher quality homes, which are professionally managed. Over the last decade, the professionally managed rental sector (Build-to-rent), and Purpose Built Student Accommodation (PBSA) have become more established investment asset classes, and more recently, investment in higher quality rental options for older people has increased.

This risk weighting applied to build-to-rent housing should reflect that there is a huge undersupply of housing in the UK, and there is high demand for new high quality homes of all tenures – it would not seem appropriate to deem it to be high risk on the basis that that it has not been pre-let (i.e. to treat it on a par with other speculative development). The build to rent business model would not typically achieve high levels of pre-lets until close to completion of the construction phase – however, this does not mean that it should be treated as a similar risk weighting to other speculative developments. Indeed,

[1] https://bpf.org.uk/media/5209/220701-bpf-response-to-cas-consultation-may-2022-final-33.pdf
[2] https://www.constructionleadershipcouncil.co.uk/wp-content/uploads/2021/05/Construction-Leadership-Council-National-Retrofit-Strategy-Version-2.pdf
[3] https://pdf.euro.savills.co.uk/uk/office-reports/how-sustainable-is-the-office-stock-in-the-uk.pdf

the huge supply/demand imbalance in housing, and the typically very low void levels makes this a very attractive investment proposition for long term investors - and the risk weightings should reflect this.