



## ABBL response to EBA CP 2024/12 on ADC exposures to residential property under Article 126a of Regulation (EU) No 575/2013

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### **4. Legally binding contracts**

#### **Significant portion of total contracts**

**Q10: Do you agree in using two different options for pre-sale/sale and pre-lease/lease contracts?**

Yes, we agree.

**Q11: Do you see any drawbacks related to the proposed options under paragraphs 14 to 16 of these Guidelines?**

The minimum percentage of 50%, calculated under option 1 of paragraph 16 as the ratio between legally binding sale contracts and the total amount of the credit facility, is acceptable for our members.

### **5. Appropriate amount of obligor-contributed equity**

**Q18: What are your views on the proposed threshold for determining the appropriateness of the amount of obligor-contributed equity? Please provide reasoning, taking into account market practices and underwriting standards if you think that an adjustment of the EBA's proposal is necessary.**

The proposed threshold considers the *Property value upon completion* as the reference to calculate the amount of obligor-contributed equity. This approach, which assumes that ADC projects are financed upfront as a whole package, does not stick to the market practice in Luxembourg where banks may finance different phases of the project separately.

The predominant market practice in Luxembourg foresees the following phases of an ADC transaction in Luxembourg:

1. Land acquisition by the real estate developer
2. Development phase, including obtention of all necessary permits
3. Marketing phase by the real estate developer via pre-sales
4. Finalization of the sales in state of future completion (VEFA) via notarial deed
5. Construction phase

The most common case is where banks finance solely the land acquisition by the real estate developer. In addition to financing the land acquisition, banks may also finance the construction of the real estate property. We explain below the features of these transactions.

## **1. Financing solely the land acquisition**

Banks intervene upstream of the project when the real estate developer acquires the land, by financing a maximum of 80% of the land price (excluding acquisition costs). Banks mostly finance land eligible for construction, thus avoiding land speculation.

A minimum equity contribution of 20% of the land price must, in general, be injected by the real estate developer. Furthermore, the bank receives a first rank mortgage on the land. During the development phase, the real estate developer applies for all necessary permits. When all necessary permits have been obtained, the real estate developer starts the sales process of the project.

Following the commercialization phase, the proceeds from the sales of the project are used by the real estate developer to first reimburse the loan financing land acquisition and then to pay the construction costs of the project.

According to the market practice in Luxembourg, a sufficient level of pre-sales needs to be achieved to finance the construction through the payments to be made by buyers under the VEFA (sale in state of future achievement) regulation. When this level is reached (70% - 80%), banks or insurance companies may issue a completion guarantee (garantie d'achèvement), which is mandatory by law to protect the buyers.

Once the completion guarantee is issued by the bank or by an insurance company, sales are finalized by notarial deed, where the notary checks the availability of the funds from the buyer, either through the buyer's own funds or via a mix of own funds and a mortgage loan granted by a bank. At that stage, buyers pay their share of the land, thus enabling the real estate developer to repay the bank loan financing the land acquisition.

Subsequently, buyers pay in installments based on the project completion.

## **2. Financing the land acquisition and the construction**

In addition to financing the land acquisition as described above, some banks also finance the construction phase of the real estate property.

In this case, banks request a minimum level of **20% of legally binding sales** of the cost of the real estate project **or the equivalent in the form of equity contribution from the real estate developer**. As a collateral, banks receive a mortgage on the properties to be constructed.

**Q19:** Do you agree to use Approach 4 for identifying the appropriate amount of obligor-contributed equity? If not, what alternative options should the EBA consider?

Approach 4 based on the property value upon completion makes sense when the whole project is financed upfront as a package. As explained in our response to Question 18, this approach does not stick to the practice of the Luxembourg market. Therefore, we suggest considering an alternative approach which would recognize the fact that different phases of an ADC project may be financed separately.

When banks finance solely the land acquisition, **the level of the obligor's contribution should be assessed in relation to the cost of the land and not by considering the value of the whole project**. The alternative threshold, with a minimum value of 20%, would be: **Obligor contributed equity / cost of the land**



When banks finance the land acquisition and the construction, the minimum level of legally binding sales (i.e. 20% of total contracts) required to finance the construction is prudent since this condition is cumulative with the minimum equity contribution of 20% for the land acquisition.

**Q20: Do you see any rationale for setting different threshold levels?**

The EBA explains that the threshold level of 35%, which exceeds current market practices, is justified by the lowering of risk weight from 150% to 100%. While we understand this rationale, we believe that the proposed level is excessive as it does not fairly reflect the specificities of market practices in Luxembourg, which grant a high degree of protection to banks and to their clients.

Therefore, we would advocate considering the thresholds of 20% exposed in our response to question 19.