To the European Banking Authority

19th of August 2024

## **Finance Iceland comments regarding changes on ADC exposures to residential property under consultation paper EBA/CP/2024/12 supplementing Article 126a of Regulation (EU) 575/2013.**

It is the view of Finance Iceland, on behalf of Icelandic banks, that the changes suggested under consultation paper EBA/CP/2024/12, which supplements Article 126a of Regulation (EU) 575/2013, will have considerable effect on both banks and real estate development in Iceland.

The cost of funding in Iceland is high due to high historical inflation and current inflation levels. The proposed changes, which require significantly higher equity from construction companies, will increase financing costs and therefore decrease the supply of new homes and commercial estates. The local demand for housing has been growing considerably, and supply has not been able to keep up with this growth. The proposed changes will further widen the gap between supply and demand.

These loans constitute a considerable part of the loan portfolios of Icelandic banks. Further requirements will drive these loans to other lenders which are not subject to such strict requirements, thereby hurting the competitiveness of the banking sector.

Icelandic banks agree that risk-weighted capital requirements should reflect the underlying risk in every asset class. However, they believe that the proposed implementation is overly conservative. Finance Iceland believes that individual countries should have some flexibility to allow for variations in the risk factors that real estate development presents in different countries.

EBA/CP/2024/12 states that the estimated capital gain must be included in the denominator, but it may not be included as equity in the numerator, reducing the calculated capital contribution. Additionally, the proposal stipulates that the equity contribution of the debtor should not be below 35% of the value upon completion to apply the risk weight of 100%.

This condition is significantly stricter than the 20% of the value upon completion that the Icelandic Financial Supervisory Authority uses for the SREP benchmarks.

In recent years, very few construction projects that received financing from Icelandic banks would have met this 35% condition. The Icelandic government has made considerable efforts to stimulate residential real estate development during this period. The proposed change contradicts this objective and is likely to have a significant impact on housing development in Iceland. If developers are subjected to such stringent capital contribution conditions as proposed, their willingness and ability to embark on construction projects will be adversely affected.

As a result, it can be inferred that an overwhelming majority of future construction projects will not meet these conditions and will therefore be subject to a higher risk weight. This leads to higher interest rates on a large majority of ADC loans for the construction of residential housing.

Finance Iceland suggest that any threshold for the appropriateness of the amount of obligor-contributed equity should be a factor of the cost of construction and not value upon completion and that the threshold be lower than the 35% suggested.

Kind regards,

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