FIEC is the European Construction Industry Federation, representing via its 33 National Member Federations in 29 countries (25 EU & Norway, Switzerland, Ukraine and Turkey) construction enterprises of all sizes, i.e. small and medium-sized enterprises as well as "global players", carrying out all forms of building and civil engineering activities. Construction accounts for 10.6% of the GDP and 6.2% of the total employment in the EU.

THE TRANSPOSITION OF BASEL III AND ITS IMPACT ON CONSTRUCTION

A CREDIT CRUNCH FOR CONSTRUCTION PROJECTS?

15/10/2021

KEY MESSAGES

A one-to-one implementation of the Basel III agreement and stricter capital requirements for banks will have two major consequences for the construction industry:

- A restricted access to finance for construction clients
- A restricted access to finance for construction companies

This will…

- negatively affect clients' capacity to invest in construction projects, including green construction projects to deliver on the EU Green Deal,
- hinder companies' day-to-day functioning
- reduce companies' investments to make their operations more sustainable
- eventually result in a loss of 440,000 jobs in the sector

Therefore, FIEC calls for:

- an impact assessment taking into account financing needs to recover from the Covid-19 crisis and to drive forward the transition to a sustainable economy
- a proportionate implementation of the Basel III agreement that sustains banks' ability to finance the EU economy, including…
  - reviewing the risk weighting related to the construction sector
  - allowing for a more granular, risk-sensitive approach for project finance
- as a supporting measure, extend the possibility for public loan guarantees under the state aid Temporary Framework

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THE CONSEQUENCES OF INCREASED CAPITAL REQUIREMENTS

I. Stricter capital requirements reduce the purchasing power of clients

European Commission Single Market Report 2021: "The main challenge is to boost property owners, including public authorities, and investors' confidence to invest in the green and digital transition of the built environment."

In the standardized approach, Basel III introduces a new category among those of real estate, related to the construction sector (ADC). This category includes exposures for the purchase of land, for the design and construction of buildings, the repayment of which derives from the sale of the asset and/or from the potential cash flow generated by it. The risk weighting for such exposures is set at 150%.

The transformation to a sustainable economy will to a large extent depend on directing financial means towards construction projects. By way of illustration, the EU Taxonomy lists economic activities having large potential to contribute to climate mitigation and adaptation. More than 50% of these are related to construction: construction of energy infrastructure such as wind power, renewal of water infrastructure, maintenance of infrastructure, energy renovation and climate resilience of buildings and the construction of highly energy efficient buildings. Especially improving the energy efficiency of the EU's building stock is a cornerstone for the transition to a carbon neutral continent. This will require massive amounts of investments in the renovation of buildings. Green construction, such as deep renovations, is costly and clients find it difficult to finance renovations or new low-emission buildings. For example, in the Netherlands, the tightening of efficiency requirements for residential buildings over the period 2015-2019 has caused construction costs to rise by about € 7,000 for multi-family houses and by more than € 9,000 for single-family houses. Simply put: Greener construction requires more capital, i.e. an enhanced investment capacity by clients. Introducing stricter capital requirements for banks would therefore constitute a major obstacle for clients to purchase greener construction. A reduction in investment in construction will make it impossible to reach the climate targets.

More capital needed for green projects ϟ stricter capital requirements

II. Stricter capital requirements reduce companies' investment capacities

Construction companies depend on an easy access to finance for their day to day operations. When awarded a new contract, construction companies pre-finance the project's realisation, i.e. start construction at their own expenses before being paid by the client. This is done with the working capital that consists of profits from previous projects and banks loans. **Construction companies' working capital is under considerable constraints**:

i. According to the European Commission's Single Market Report 2021, almost 30% of construction companies face financial distress due to the Covid-19 crisis.

ii. Currently, companies' liquidity is supported through public loan guarantees under the State aid Temporary Framework.

iii. A surge in prices in construction materials since the beginning of 2021 threatens the financial health of construction companies all over the EU.

iv. Late payment by clients is a widespread phenomenon in the industry which is even expected to aggravate in the aftermath of the Covid-19 crisis.

Therefore, affordable bank financing is essential for companies' ability to operate. Also, construction companies must be able to make their own operations more sustainable, for instance through investments in more sustainable machinery. Investments in the transition to sustainable construction are costly. By way of illustration, on average, an electric construction machine costs about two to three times as much as the comparable fossil-based version. For such investments, an easy access to capital is indispensable.

III. Stricter capital requirements will ultimately lead to a loss of jobs in construction

The construction industry is an economic heavyweight. It accounts for 10.6% of EU GDP and 6.2% of the EU's total employment providing jobs for 12.7 million people. Employing 24.9 million people, the wider construction ecosystem is even more significant. A strict implementation of Basel III risks reducing the purchasing power of clients and limiting the capacity for construction companies to deliver on projects, thereby reduce the amount of construction projects. This will ultimately result in a loss of jobs. According to our estimates, a one-to-one implementation of the Basel III standards would put 440,000 jobs in the EU's construction ecosystem at risk.