

Amended BelWertV (Mortgage Lending Valuation Ordinance): vdp's position on individual paragraphs

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§3(2): Period under consideration, including documentation

*(2) ¹To determine the mortgage lending value, the future marketability of the property is to be taken as a basis within the scope of a prudent valuation, by taking into account long-term sustainable characteristics of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. ²The determination of sustainable characteristics of the property and their influence on the valuation **requires a long-term view of market conditions.** ³The period under consideration shall be specified and its appropriateness comprehensibly explained.*

Background to the change:

The determination of the mortgage lending value is to be based even more closely on a long-term view of market conditions.

vdp's position:

From vdp's perspective, both *taking into account market conditions over the long term* and also *comprehensibly explaining the appropriateness of the period under consideration*, which complies with the principle of a prudent, sustainable and long-term determination of the mortgage lending value, should depend on the type of property concerned, the region and the individual data available. Specifying a fixed and purely historical period would not do justice to the peculiarities of individual types of property and regional sub-markets, and the related differences in the volume of data available. That is why the Ordinance is right not to provide for a minimum period under consideration.

The extent to which *the appropriateness of the period under consideration* needs to be documented should be appropriate to the risk in terms of the type and complexity of the property.

When considering market conditions, priority must be given to overall trends for those properties in the region that are relevant to the type of property in question. In the case of mixed-use properties, if one use is clearly dominant in the valuer's opinion (the main use), the documentation can be limited to the main use.

When identifying the period and documenting the market conditions / overall trends, reference can be made to helpful diagrams and tables, and to data series showing the relevant time periods, including in a standardised form.

Generalised procedures such as the use of average values or minimum or maximum values over a selected period, or extrapolating past market trends, do not adequately reflect the heterogeneity of real estate markets or the qualities of individual properties.

§4(1) sentence 3: Tax perspective

*³If the depreciated replacement cost value or, in the case of sentence 1 second half sentence, the comparative value of the property serving as collateral is more than 20 percent below the income value, a special review of the sustainability of the adopted underlying income and its capitalisation is necessary: in this context, the same assumptions, in particular with **regard to taxation**, are to be taken into account within the scope of the control review for the cost and income approaches.*

Background to the change:

In terms of the requirement for “equality of tax treatment”, BaFin (the Federal Financial Supervisory Authority) is particularly mindful that the control function of the depreciated replacement cost value (where the income value is more than 20% greater than the depreciated replacement cost value) will be lost if a uniform approach is not taken when applying the income and cost approaches – e.g. using net rents but gross construction costs.

Vdp’s position:

The new wording pertaining to the tax perspective relates to the control function enshrined in the two-pillar principle. A wide range of factors can influence the tax perspective due to, for example, types of use, the types of investors and the decisions that they make, as well as the tenant structure. These factors can also change over a property’s useful life. The tax perspective can therefore only be a snapshot; no account can be taken of speculative considerations when determining the mortgage lending value.

For this reason, it would not seem sensible to consider implementing the above wording of the Ordinance in more detail. Instead, due to the complexity of the situation it has to be possible to deal with this provision flexibly by implementing it in different ways.

§4(2) sentence 2: Lettings discount

(2) ¹In the case of single-family and semi-detached houses as well as condominiums, the mortgage lending value may take its bearings from the depreciated replacement cost value or the comparative value and a determination of the income value may be dispensed with if the property being valued is without doubt suitable for owner-occupation due to the quality of property and the location and is in lasting demand by potential buyers for owner-occupation.

²In the event that the property is still let, the associated reduction in value is to be determined in a comprehensible manner and deducted from the mortgage lending value. [...]

Background to the change:

Clarification that the property is currently let should, in principle, be taken into account to reduce the value in the case of properties suitable for owner-occupation.

vdp's position:

A so-called "lettings discount" is not necessary if:

- the letting of the property has already been taken into account in appropriate comparative values, or
- it has been clearly explained that the letting of the property has no effect on the value in the particular case.

§4(2) sentence 4: Sustainability discount from the depreciated replacement cost value (deletion of §18)

*[...] ³In the case of single-family and semi-detached houses, however, subject to §19(2), the mortgage lending value may only take its bearings from the comparative value if the determination is based on up-to-date comparable prices of at least five properties that sufficiently correspond to the property to be valued also with regard to the size of the living space. ⁴When determining the mortgage lending value based on the depreciated replacement cost value, regular reviews must be carried out **as to whether a deduction from the depreciated replacement cost value is necessary due to characteristics of the property and the local market conditions, taking particular account of sustainability.***

Background to the change:

Clarification that checks should normally be made when deriving the mortgage lending value from the depreciated replacement cost value, so as to establish whether adjustments are required. To minimise risk, as a matter of principle, there is no provision for upward adjustment.

vdp's position:

The wording of the provision does not explicitly preclude surcharges and mark-ups, but rather it is about checking whether discounts are needed. Surcharges and mark-ups on the depreciated replacement cost value, e.g. due to particular property-specific characteristics or special market conditions, should be possible where justified in individual cases.

§12(3) and (4) and §25(1) and (3) BelWertV: Determining capitalisation rates for properties located abroad

The amended BelWertV published on 7th October 2022 includes a change to the minimum capitalisation rates to be applied when using the income approach. The previous fixed rates (5% for residential properties and 6% for commercial properties) have been changed to a dynamic derivation model, based on the interest rate payable on 30-year German Federal Bond plus a risk premium, subject to upper and lower limits.¹ This derivation model, enshrined in §12(4) BelWertV, specifically refers only to properties located in Germany. §12(5) BelWertV, which deals with the possibility of reducing the minimum capitalisation rates for first-class properties, and Annex 3 which deals with surcharges and mark-ups for certain types of properties, both refer to §12(4) BelWertV, and thus also only apply to properties located in Germany.

Moreover, §25(1) BelWertV has been rewritten.² This provides that the mortgage lending value of properties located abroad is to be determined in accordance with the other provisions of BelWertV only to the extent that nothing else is prescribed in those provisions and §25(2) - (5) BelWertV.

This means that only §12(3) and §25(3) BelWertV apply to the capitalisation rates used for properties located abroad. The capitalisation rate must be derived from the long-term and use-specific market trends applicable in the region; different types of use must be considered separately.³ In addition, when deriving the applicable capitalisation rate, an appropriate weighting must be given to the highest values achieved in the relevant market, unless they have been achieved only for short periods.⁴

The minimum capitalisation rates set by BaFin in accordance with §12 para. 4 BelWertV, currently 5.1% for residential properties and 6.1% for commercial properties, are expressly stated to apply only to Germany.

¹ §12(4) BelWertV: *“Subject to sentence 3 and paragraph 5, the capitalisation rate for properties located in Germany shall be, in the case of residential use, at least 3 percentage points above the yield of 30-year German federal bonds as published by the Deutsche Bundesbank, rounded in accordance with DIN 1333, and, in the case of commercial use, at least 4 percentage points above said yield, plus, in both cases, any markups to be taken into account for individual types of use in accordance with Annex 3. ²If, on 30 November of any year the yield on 30-year German federal bonds as published by the Deutsche Bundesbank is at least 0.5 percentage points higher or lower than at the beginning of the month preceding the last change in the minimum capitalisation rates, these shall change on 1 January of the following year by the corresponding percentage points, rounded to the first decimal place in accordance with DIN1333. Subject to paragraph 5, the minimum capitalisation rate for residential use shall be at least 3.5 percent and at most 5.5 percent, and for commercial use at least 4.5 percent and at most 6.5 percent, plus any markups to be taken into account for individual types of use in accordance with Annex 3. ⁴BaFin shall publish the amended capitalisation rates on its website without delay after the date specified in sentence 2.*

² §25(1) BelWertV: *‘The determination of the mortgage lending value of properties located outside of Germany is to be conducted in accordance with the other provisions of this Regulation unless otherwise stipulated in pars. (2) to (5).*

³ §12(3) BelWertV: *“The capitalisation rate corresponds to the assumed interest rate at which the sustained net income, achievable in future, of a property is discounted over the period of its assumed payment on the basis of a prudent assessment and based on experience. ²It must be derived from long-term use-specific market trends applicable in the region. ³Different types of use must be considered separately in each case.”*

⁴ §25(3) BelWertV: *“In deriving the capitalisation rate to be stated in accordance with §12 par. 3, the peak values achieved in the respective market not only on a short-term basis must be suitably weighted.”*

vdp's assessment:

The new provision makes it possible to apply capitalisation rates which are lower than the minimum capitalisation rates under §12(4) BelWertV for properties located abroad if the requirements of §12(3) and §25(3) BelWertV are met.

This allows a better differentiation between properties in terms of market- and property-specific risks when determining the mortgage lending value.

§13(1) BelWertV: Site clearance date, basic rule

*(1) ¹If, when the net income is reduced by the interest rate amount in respect of the land value in accordance with §9 par. 2, no part is left for the determination of the income value of the building(s), then, notwithstanding §8 par. 3, only the land value in accordance with sentence 4 is to be stated as the income value of the property serving as collateral. ²In this case, the land value is to be reduced by the usual costs that would be incurred to bring the site in line with comparable undeveloped sites. ³Usual costs within the meaning of sentence 2 are in particular the costs for the demolition of the building(s). ⁴**The land value thus determined, reduced by the demolition costs, shall be discounted from the time when the undeveloped site would be available to the valuation date, using the capitalisation rate to be applied for the permissible use.***

Background to the change:

The land value is discounted from the presumed date of clearance to the valuation date to reflect the fact that the land will not be available for new income-generating development until after it has been vacated.

vdp's position:

The purpose of this provision is to take account of buildings that are no longer economically viable and are due for immediate removal (clearance properties). Due to the disproportionate increase in land values in recent years compared to sustainable rental trends, together with a decoupling of minimum capitalisation rates from current events in the market (current property yields), this provision currently applies predominantly to properties with an economically sustainable use, such as many residential properties in the major German conurbations.

To the purely fictional demolition, which in many cases is wholly impossible under planning law because of, for example, historic monument protection, there is now added an obligation to determine a presumed site clearance date, as an additional and in most cases notional element. The prescribed methodology does not reflect the actual situation.

Besides a procedure that meets current regulatory requirements (see below), vdp therefore also advocates a fundamentally new provision which should be considered when BelWertV is further revised.

Determination of the future clearance date

Residential use:

Determining the future site clearance date is sometimes difficult in the case of rented residential properties, since the bank often does not have all the relevant information available or, in the case of residential uses, the collection, storage and use of such information is not permitted for data protection reasons.

The statutory notice period in Germany is a maximum of 9 months, depending on the duration of the lease. It may be 12 months for leases concluded before Autumn 2001.

Taking into account

- the fact that the information available for the particular property is often insufficient,
- the statutory notice periods which are difficult to enforce in practice, and
- the time that would need to be estimated for demolition to take place,

vdp considers that for residential use it would be appropriate to allow two years to clear the site, or as the period over which the land value is discounted up to the valuation date.

Commercial use:

The statutory notice period for commercial leases in Germany is six months.

Adopting the same approach as for residential properties, vdp considers that it would be appropriate to allow two years to clear a commercial use site, or as the period over which the land value is discounted up to the valuation date.

§14 sentence 4 and 5: Discounting of demolition costs

*§14 ¹The depreciated replacement cost value of a property serving as collateral is made up of the land value and the value of the building(s) to be calculated in accordance with §16. ²The reduction in value due to age in accordance with §17 is to be taken into account. ³The outdoor installations also belong to the building(s). ⁴**If the remaining useful life of the building is less than 30 years, the demolition costs of the building shall be determined and deducted from the depreciated replacement cost value. ⁵In respect of the discounting of the demolition costs, §13 par. 1 sentence 4 shall apply accordingly.***

Background to the change:

In the same way as under §13(2), demolition costs should be applied where the remaining useful life is less than 30 years and the cost approach is used to ensure consistent application of the two-pillar principle, which normally has to be applied pursuant to §4.

vdp's position:

In relation to the discounting of demolition costs and the reference to §13(1) sentence 4, vdp interprets this provision as meaning that demolition costs must be discounted over the remaining useful life of the building.

For income value properties falling under §13(2), the demolition costs must always be determined, irrespective of the option selected (not dealing separately with the income, or income value minus demolition costs), since §14 does not provide for a corresponding choice and therefore the discounted demolition costs must be taken into account in the depreciated replacement cost value as a control.

§19(2): Single-family and semi-detached houses: verification using random sampling based on the cost approach

(2) ¹Notwithstanding par. 1 sentence 2, in the case of single-family and semi-detached houses as well as of condominiums, the comparative value may also be determined using computer-assisted database-supported valuation models if their suitability and the underlying data comprehensibly derived on the basis of suitable statistical models are validated at least annually by a qualified body independent of the system provider and database provider. ²The valuation results must also be reviewed by the Pfandbrief bank at regular intervals within the scope of quality assurance; §24 par. 2 sentence 3 shall apply accordingly with the proviso that, in the case of lendings on single-family and semi-detached houses, the cost approach is to be used for the review. The samples must, in particular, also be representative according to the type and regional location of the properties.

Background to the change:

Determining the depreciated replacement cost value by sampling as a control calculation, to provide an additional safeguard for the quality of the comparative values determined with the aid of statistical methods.

vdp's position:

The comparison approach and the cost approach are independent of one another. Where the value determined using the comparison approach is based on a direct or indirect price comparison with suitable comparable properties, the cost approach concentrates on an analysis of the intrinsic value, consisting of the land value and the costs which would be incurred in construction.

Due to the different input parameters and the related regulatory requirements, different valuation outcomes will inevitably result depending which approach is adopted.

If all the other general requirements for determining the mortgage lending value are met, particularly the requirements of §19(2), then a substantial difference between the comparative values and the depreciated replacement cost values used for the sample check does not automatically indicate that the comparative value has not been determined properly. There are also no regulatory requirements that, above a certain scale, differences between the comparative value and the depreciated replacement costs value require an in-depth analysis or even a need for adjustment. The only requirement to be taken into account is that the mortgage lending value may not exceed the market value, as stipulated in § 16 PfandBG.

§26(1): Event-driven review vs. administrative adjustment of minimum capitalisation rates

*(1) ¹The mortgage lending value shall be monitored at least annually. **Where indications exist to the effect that the basis of the determination of the mortgage lending value has declined not only insignificantly, it must be reviewed.** ²In particular, this applies when the general price level in the respective regional property market has fallen to an extent that jeopardises the safety of the lending. ³Unless owner-occupied residential properties are concerned, a review must also be conducted if the claim secured by the property serving as collateral shows substantial payment arrears of at least 90 days. ⁴The mortgage lending value is to be reduced if necessary.*

Background to the change:

No change.

vdp's position:

If the supervisory authority adjusts the minimum capitalisation rates pursuant to §12(4), this does not automatically mean that the mortgage lending value needs to be reviewed. Instead, the requirements of §26 BelWertV must be understood to mean that any indications that the conditions underlying a determination of the mortgage lending value have deteriorated should continue to be based on market activity and not on a regulatory change.

Annex 1 – Maintenance costs: allocation of property types/ types of use to the three categories

Basis of calculation: construction costs per square metre of living space or floor area (excluding incidental building costs and outdoor installations). The state of the property, the standard of fixtures and fittings and the age are to be taken into consideration when calculating the maintenance costs.

- a) Warehouses, production plants, simple-standard commercial properties and self-service consumer markets: 0.8 per cent*
- b) Residential buildings and medium-standard commercial buildings: 0.5 per cent*
- c) High-grade office and retail properties and other commercial properties: 0.4 per cent*

Background to the change:

Unknown.

vdp's position:

The new BelWertV now contains three maintenance cost classes instead of four. While the property and use types listed in the respective classes were still marked with the addition "e.g." in the old BelWertV, this addition is dropped with the BelWertV amendment.

From the vdp's point of view, the focus is still on a maintenance cost calculation appropriate to the state of the property, the standard of fixtures and fittings and the age of the specific property. The omission of "e.g." in relation to the property types listed under a) to c) does not mean that every property is to be assigned to a specific class a) to c) solely on the basis of its property type, irrespective of the actual property characteristics.

It should still be possible, for example, to assign a higher-value warehouse or a higher-value self-service consumer market to category b) if the associated maintenance cost rates are considered appropriate for the specific case by the valuer and are justified accordingly in the valuation report.

Annex 1 – Maintenance costs: guideline figures for garages and underground parking spaces are missing

Basis of calculation: construction costs per square metre of living space or floor area (excluding incidental building costs and outdoor installations). The state of the property, the standard of fixtures and fittings and the age are to be taken into consideration when calculating the maintenance costs.

- a) Warehouses, production plants, simple-standard commercial properties and self-service consumer markets: 0.8 per cent*
- b) Residential buildings and medium-standard commercial buildings: 0.5 per cent*
- c) High-grade office and retail properties and other commercial properties: 0.4 per cent*

Background to the change:

Unknown.

vdp's position:

BeIWertV does not specify separate factors for garages and underground parking spaces. Accordingly, the use-specific percentages referred to in points (a) to (c) or the individual cost factors of a corresponding amount apply.

It is not necessary to show maintenance costs for garages and underground parking spaces separately if the construction costs for garages and underground parking spaces have already been adequately taken into account in the construction cost factor for the entire property.

Annex 1 – Modernisation risk: “No modernisation risk” category deleted

Modernisation risk

The basis of calculation are the construction costs (without incidental building costs and outdoor installations).

- ~~a) **No modernisation risk (e.g. normal apartment buildings, small apartment and commercial buildings, small and medium-sized office buildings, warehouses and production halls): 0% to 0.3%**~~
- a) *Low modernisation risk (e.g. larger office buildings, apartment, office and commercial buildings with special features regarding fixtures and fittings, simple-standard retail): 0.2 per cent*
- b) *Medium modernisation risk (e.g., inner city hotels, higher-standard retail, simple-standard leisure properties): 0.5 per cent*
- c) *High modernisation risk (e.g. rehabilitation facilities, clinics, higher-standard leisure properties, hotels and especially high-standard retail properties): 0.75 per cent.*

Background to the change:

Editorial changes.

vdp’s position:

The deletion of the “No modernisation risk” category which still appeared in the old BelWertV does not mean that a modernisation risk should now be recognised in every case. For the use categories and properties previously mentioned under a) above in the old BelWertV, as a rule there is still no need for modernisation risk to be considered.