

**EBA Guidelines on Loan Origination & Monitoring:  
vdp position on individual paragraphs of relevance to valuation work**

**1. Background**

On 29<sup>th</sup> May 2020, the EBA published its Guidelines on Loan Origination & Monitoring.

The requirements take effect for new loans from 30<sup>th</sup> June 2021. A two-year transition period applies to renegotiations of existing loans, so that the requirements apply from 30<sup>th</sup> June 2022. For monitoring requirements (Section 8 of the guidelines), missing information must be collected and internal procedures adapted by 30<sup>th</sup> June 2024.

The requirements apply directly to institutions supervised by the ECB. At national level, the EBA guidelines will be implemented in 2021 through further amendments to *Mindestanforderungen an das Risikomanagement*, MaRisk. Experience has shown that, when making changes to MaRisk, German banking regulation is very much based on the European concepts in the relevant guidelines.

Banks supervised by the ECB in particular have collated questions on interpretation and implementation, and also initial positions/solutions for assessing creditworthiness and issues affecting the monitoring of real estate values. These topics are dealt with below as follows:

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Paragraphs relating to advanced statistical models have been largely excluded from this paper for now, as in all likelihood the minimum requirements for computer-aided property valuation will be discussed in conjunction with the forthcoming amendment to the Regulation on the Determination of the Mortgage Lending Value (BelWertV).



## 2. vdp position on individual paragraphs

### Paras. 206 + 209

206. *When a credit facility is secured by an immovable or movable property collateral, institutions should ensure **that the valuation of the collateral is carried out accurately at the point of origination**. Institutions should set out internal policies and procedures for the valuation of collateral. These policies and procedures should specify the valuation approaches to be used by a valuer and the use of advanced statistical models for each type of collateral. Institutions should ensure that these approaches are prudent and proportionate to the type and potential values of the collateral and in relation to the credit agreements, and are in line with the credit risk policies and procedures and conditions set out in Section 7.4.*

209. *At the **point of origination**, institutions should ensure **that the value** of all immovable property collateral for loans to consumers and micro, small, medium-sized and large enterprises is assessed by an internal or external valuer **using a full site visit with internal and external inspection of the property**.*

#### vdp position:

Before lending, banks often check the intrinsic value of collateral on the basis of an indicative value. At the time of lending, a full valuation or a valuation report including a site visit complying, for example, with the requirements of BelWertV is not yet achievable, and it is then carried out later. This approach is MaRisk-compliant and established with the supervisory authority. vdp assumes that this approach is consistent with the wording of paragraphs 206 and 209: Thus, "... ensure that the valuation of the collateral **is** carried out accurately at the point of origination ..." in para. 206 and also "... ensure that the value (...) is assessed (...)" in para. 209 indicates that the accurate valuation required by these paragraphs should already have been started at the time of lending, but it need not be completed at that point.

The EBA guidelines do not restrict the derogations in BelWertV §24 paras. 3 and 3a for site visits in relation to small loans.

### Para. 210

*As a derogation from paragraph 209, for the purposes of a valuation of residential real estate **in well-developed and mature real estate markets**, the value may be assessed by means of a desktop valuation, carried out by an internal or external valuer and supported by advanced statistical models. The valuer remains responsible for the valuation, while the advanced statistical models should be used as supporting tools, meeting the conditions set out in Section 7.4, and including a confidence measure to indicate the robustness of the value proposal and other relevant property-specific information. In this case, the value proposal should be assessed, reviewed and approved by the internal or external valuer, who should understand all inputs and assumptions considered in the model. If the confidence measure in the supporting advanced statistical model indicates low robustness, and/or other property-specific information gives rise to uncertainty about the value proposal, the valuer should choose a valuation method other than desktop valuation.*

vdp position:

It can be assumed that Germany is a well-developed and mature market in the sense of this paragraph. This can be deduced in particular from the fact that precisely this wording was chosen in connection with evidence of maximum loss rates in CRR Art. 125 para. 3 and Art. 126 para. 3. It can be shown that loss rates in Germany have been below these limits continuously since 1988.

**Para. 212**

*Institutions should ensure that the valuers provide an impartial, clear, transparent and objective valuation, and each valuation should have a final report providing the necessary information on the valuation process and property. The valuation report should clearly state who ordered the valuation and that the valuation has been requested for the purposes of a loan application, renewal or contractual adjustments, or in the case of structural changes. A valuation should be carried out (internal valuation) or ordered (external valuation) by the institution or a collateral agent (in the case of syndicated loans) **unless it is subject to a request from the borrower.***

vdp position:

Any interpretation that could allow a client to commission a valuation is categorically rejected for appraisals of both market value and mortgage lending value.

**Para. 214**

*Institutions should **critically review the valuation they receive** from the valuer, in particular focusing on aspects such as comprehensibility (whether the approaches and assumptions are clear and transparent), the prudence of assumptions (e.g. as regards cash flow and discount rates), **and the clear and reasonable identification of comparable properties as a value benchmark.***

vdp position:

vdp emphasises that *critically review* cannot under any circumstances mean introducing new and additional levels of checks for valuations/reports beyond those carried out by the valuer (e.g. by lenders). The verification, checking and control mechanisms required by the regulations are well-established and sufficient.

vdp must also point out how difficult direct price comparisons are in the commercial property sector. *Comparable properties* must therefore also be interpreted in the sense of an indirect price comparison, i.e. calculating comparable values by, for example, applying the capitalized income value to units within a loan property (as is customary for shopping centres, for which usually there are no direct comparable values but there are corresponding key comparable figures such as typical space productivity).

**Paras. 215 + 216**

*215. At the point of origination, institutions should ensure that the value of all **movable property** collateral is assessed through an appropriate and prudent approach that is proportionate to the nature, type and complexity of the collateral, by an internal or external valuer, appropriate advanced statistical models meeting the conditions set out in Section 7.4*

or other standard methods, such as indexation, taking into account the market value as referred to in Article 229(3) of Regulation (EU) No 575/2013.

216. When applicable, institutions should set out, in their policies and procedures, approaches for the purposes of this valuation, and specify internal thresholds and limits that require an individual valuation of movable property collateral at the point of origination to be performed by a valuer.

vdp position:

In Germany, the valuation of movable assets and associated procedures is not seen as part of the valuation of the property, which is limited to its essential elements. The corresponding parts of the EBA guidelines are therefore not relevant to real estate valuers in the context of property valuations.

### **Para. 222**

*Institutions should set out appropriate frequencies for monitoring the value of the collateral, considering the type and value of the collateral at origination, and, in relation to the credit agreement, consider the following:*

- a. the **frequency of monitoring** of properties and parts in development, e.g. unfinished buildings, is higher than that of similar finished properties and parts;*
- b. the **frequency of monitoring** of properties and parts with a high carrying amount or with a high LTV ratio is higher than that of similar properties and parts with a low carrying amount or with a low LTV ratio;*
- c. the **frequency of monitoring** of loans secured by immovable property or parts of the property with lower credit quality is higher than that of similar loans secured by immovable property or parts of the property with higher credit quality.*

vdp position

The appropriate frequency should be based on the requirements of EBA Guidelines on management of non-performing and forborne exposures (NPE GL) and the MaRisk requirements. For the purposes of reduced equity capital risk weightings, the requirements of CRR Art. 208 para. 3 must also be considered.

vdp rejects the possibility of deducing from para. 222 that in principle monitoring of certain properties should be carried out more than once a year. The rules under CRR Art. 208 para. 3, MaRisk BTO 1.2.2 and BelWertV §26 BelWertV, pursuant to which property values are checked as required and monitored regularly, are well-established and sufficiently tight. In the event of major fluctuations in value, for example as a result of technical, economic or ecological shocks, institutions are encouraged to monitor the situation at close intervals and as required (see Art. 208 (3)(a), 2<sup>nd</sup> sentence, MaRisk BTO 1.2.2 point 3 and BelWertV §26 para. 1).

### **Para. 225**

*When the conditions for a review in accordance with Article 208(3)(b) of Regulation (EU) No. 575/2013 are met, institutions should update the value of the immovable property collateral by*

*means of a revaluation carried out by a valuer who is potentially supported by appropriate advanced statistical models that meet the conditions set out in Section 7.4 and account for individual characteristics of the property and geographical area. Institutions should not use these models as the sole means of the revaluation.*

vdp position:

This paragraph (English text) can be interpreted in such a way that each review automatically leads to a revaluation. The position is governed by the provisions of CRR Art. 208(3) and BelWertV §26. A revaluation is necessary only if the review actually shows indications of a material loss in value.

In this case, vdp's view is that "revaluation" does not require the preparation of a new report. In a statement by BaFin (No. BA 27- FR 2402 - 2008/0001) dated 25<sup>th</sup> June 2008 on monitoring values (see also vdp Circular No. 89/2008) and the treatment of market fluctuations<sup>1</sup>, the question is whether the general market value fluctuations observed in a market volatility model lead to a universal obligation to revalue the properties concerned:

*"A revaluation requires at least that a person with the required technical and specialist knowledge, who must not be an employee of the lending bank involved in processing the loan, must **check** whether the initial appraisals of the underlying conditions and the other assumptions concerning the relevant market on which the valuations are based remain valid, and must document this in a comprehensible manner. If it turns out that the assumptions made and conclusions reached at the time are no longer correct, the value of the property charged as collateral must be determined again."*

**Para. 232**

*Institutions should ensure that the fee or the salary of the valuer and the result of the valuation are not linked in a way that leads to a conflict of interest.*

vdp position:

The rules do not preclude a link between the payment and the valuation result *per se*. In principle, when setting fees, clients can continue to differentiate by reference to the result of the valuation, the type of property, the complexity or size of the property and the associated effort required from the valuer, as long as there is no conflict of interest arising from the nature of the differentiation. If the fees are based on the result of the valuation (property value), this means that there must be no direct incentive to report a higher value to achieve a corresponding increase in the fee, so that the link referred to in Para. 232 does not arise. This can be achieved, for example, by linking fee levels to sufficiently wide property value bands.

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<sup>1</sup> The BaFin statement refers to Banking Act [KWG] §20a para. 6 as it then applied. Since 1<sup>st</sup> January 2014, the rules and requirements in paragraphs 4 to 8 applicable to property valuation can be found in CRR Arts. 208 and 229.

#### **Para. 234**

*In order to mitigate any conflict of interest sufficiently, institutions should take reasonable steps, e.g. via contractual terms, to ensure that valuers who are going to carry out the actual appraisal of a given property and their first-degree relatives meet all of the following conditions:*

- a. **they are not involved in the loan application, assessment, decision or administration;***
- b. they are not guided or influenced by the borrower's creditworthiness;*
- c. they do not have an actual or potential conflict of interest regarding the property in question, the valuation process and the result of the valuation;*
- d. they do not have any direct or indirect interest in the property;*
- e. they are not related to either the buyer or the seller of the property.*

#### vdp position:

The question which arises is to whom valuers should declare this in the case of syndicated financing; of course it must be declared to the commissioning bank, but must it also be declared to all the other banks participating in the syndicate, especially if banks do not join the syndicate until a later date?

There is no need for valuers to make a (retrospective) declaration to banks which join the syndicate later. A time factor must also be taken into account when assessing a possible conflict of interest. When the report was drawn up, there was no conflict of interest with the bank which joined the syndicate later, as it was quite simply not known that the bank would join the syndicate. A conflict of interest cannot arise subsequently after the report has already been completed. Therefore, no retrospective declaration is needed. However, if the valuer did further work, for example preparing a new updated report, a declaration would be needed vis-à-vis the entire syndicate.

#### **Para. 235**

*Institutions should **ensure an adequate rotation** of valuers and define the number of sequential individual valuations of the same property that can be performed by the same valuer. Any further revaluations beyond this number should result in the rotation of the valuer, resulting in the appointment of either a different internal valuer or a different external valuer.*

#### vdp position:

vdp views the following instances as individual valuations within the meaning of this paragraph: initial valuation, revaluations if they become necessary as a result of a review of value and revaluations in connection with a new lending decision.

By contrast, the following are not individual valuations within the meaning of the paragraph: indicative values, desktop valuation updates, expert opinions, plausibility checks as well as construction progress and inspection reports and releases of collateral.

This applies exclusively to individual valuers and does not require a change in the firm instructed.

Following the explanation of MaRisk BTO 1.2 No. 3, a change should take place if the same valuer entrusted with the valuation has performed two consecutive individual valuations of the same property.

### 3. Implementation of additional data requirements in the lending process: alerting valuers to additional future duties and responsibilities, particularly provision of information

In some paragraphs the EBA guidelines require that the institution must have appropriate information on the property at its disposal, without referring specifically to property valuation. Valuers should be aware of these requirements, as this may result in additional work for them, particularly in terms of providing information to the bank.

This applies particularly to the following requirements:

- **Paras. 56 - 58:** in future, ESG factors and ESG risks are to be reflected in credit risks. This requirement is addressed primarily to institutions' risk management systems. However, in the future valuers will probably provide data on the classification of certain risks and their effect on the value of the collateral, or take individual risks – especially climate and environmental risks – into account implicitly and/or explicitly in their valuation approaches.
- **Paras. 60 - 62:** under the heading Data Infrastructure, these paragraphs require institutions to have strategies and procedures in place for the lending process and for the management and monitoring of credit risk over the entire term of the credit facilities (e.g. lending and assessment of creditworthiness, risk assessment, credit review and monitoring). There must also be information available about the collateral. In future, valuers will increasingly provide data over the term of the loan, e.g. for monitoring purposes.
- **Para. 113:** this requires sensitivity analyses as part of the assessment of creditworthiness depending, among other things, on the property risk. In future, valuers may act at least as a supplier of information in relation to the property in question for the purpose of preparing these analyses.
- **Paras. 133 + 160:** here, institutions are required to check the borrower's knowledge/skills needed to manage transactions to which the loan agreement relates. This requirement may also require, for example, evidence of functioning asset and/or property management. This may make (additional) information necessary, which in future will be generated by valuers as part of their inspection and assessment of the property.
- **Paras. 169 - 172:** these paragraphs also oblige institutions to examine the borrower's suitability for management in connection with the loan assets and also the characteristics of the property (sustainable profitability, tenant quality, lettability, etc.) in connection with the borrower's ability to repay the loan. Valuers may have to become more closely involved, in order to provide the relevant information.