An Update on EU Law Impacting Valuation

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AGENDA

- A Revised Capital Requirements Regulation
- EU Green Deal

Capital Requirements Regulation
Capital Requirements Directive (CRR/CRD IV)

- The 'CRR/CRD IV' package transposed new standards on bank capital (Basel III agreement) into the EU law from 1 January 2014

- Deals with the problem of banks holding insufficient capital by setting stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity and sets rules for the treatment of mortgage collateral capital

- The CRR/CRD IV package is not only of significance to the world of banking but also impinges on real estate valuation

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Capital Requirements Regulation

Article 229(1)

*"For immovable property collateral, the collateral shall be valued by an independent valuer at or at less than the **market value**…*

*In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or at less than the **mortgage lending value…** "*

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Capital Requirements Regulation
Market Value and Mortgage Lending Value

Article 4 *(76) 'market value'*

means, for the purposes of immovable property, the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion;

Article 4 *(74) 'mortgage lending value'*

means the value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property;

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European Commission’s Proposed New Valuation Basis: “Property Value”

Proposed Addition to Article 4

(74a) ‘property value’

means the value of immovable property determined in accordance with Article 229 (1)

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PROPOSED REVISION TO ARTICLE 229 CRR

Valuation principles for eligible collateral other than financial collateral

paragraph 1 is replaced by the following:

'1. The valuation of immovable property shall meet all of the following requirements:

(a) the value shall be appraised independently from an institution's mortgage acquisition, loan processing and loan decision process ***by an independent valuer*** *who possesses the necessary qualifications, ability and experience to execute a valuation;*

(b) the value is appraised using ***prudently conservative valuation criteria*** *which meet all of the following requirements:*

(i) ***the value excludes expectations on price increases;***

(ii) ***the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;***

(c) the value is not higher than ***a market value*** *for the immovable property where such market value can be determined…*

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TEGOVA's Interpretation of Prudently Conservative Valuation Criteria (i).

the value excludes expectations on price increases;

- Exclusion relates to asking prices in the property market or forecasts at the date of valuation but which may be higher than supported by market evidence immediately prior to the valuation date
- The valuer should not reflect any such expectation of an increase in sale prices in the future
- This does not preclude the possibility of the valuer having regard to increasing prices, as observed between the dates of recorded sales transactions and the date of valuation.
- BUT such rising trends should not be forecast beyond the valuation date.

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TEGOVA’s Interpretation of Prudently Conservative Valuation Criteria (ii)

ii) the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;

- *“market price*" should be understood as the price agreed or paid for the property.
- Requiring an adjustment to be made to the market price adjusted if necessary under criterion i), to reflect any risk that this *'market price'* may be significantly higher than the value that would be sustainable over the life of the loan.
- Important to identify the risk of this occurring, as indicated by the words *“the potential for the current price to be significantly above…*".
- The required adjustment is mandatory if it is not possible to exclude such risk.

TEGOVA's Interpretation of Prudently Conservative Valuation Criteria (ii) continued

- No need for a separate valuation but an arithmetical '*adjustment*' to the "value"
- Valuer advised to undertake an analysis of the market in the context of its cyclicality.
- If the market price of the property was agreed when the market was at the peak of the market cycle, there is likely to be a risk that the price will be significantly higher than the value that could be sustained over the term of the loan.
- By contrast, if the price was agreed when the market was at the bottom of the market cycle, there is probably little such risk.
- In addition, all other known factors should be taken into account in the assessment of the described risk. For example, the oversupply of a particular type of property may lead to a decrease in prices in the future and thus to a decrease in the value of the assessed property in the future.

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THE EUROPEAN GREEN DEAL

- The European Green Deal is a package of binding EU legislation for the complete decarbonisation of the EU by 2050 and a 55% reduction in GHG emissions by 2030.
- A number of these EU laws target the building stock, the largest energy consumer (40%) and GHG emitter (36%). The key laws are the Energy Performance of Buildings Directive and Energy Efficiency Directive which set direct energy efficiency renovation obligations.
- The deadlines for the initial building and renovation obligations are so close (2030, 2033 and 2034) that they will almost immediately effect real estate market values
- The Energy Efficiency Directive is a done deal; publication in the OJEU is imminent. The EPBD is still under negotiation between the Council of Ministers and the European Parliament (agreement expected before year end). What follows is the TEGOVA's best guess on the final compromise.

ENERGY PERFORMANCE OF BUILDINGS DIRECTIVE

- All new buildings to be zero-emission as of 01.01.2030. Member states are free not to apply this to buildings for which building permit applications were submitted before 01.01.2030
- Energy performance certificates are the triggers underpinning the all-important minimum energy performance standards (MEPS, next slide) which is why they have been partially harmonised
- Now across the EU, EPC class 'A' means a zero-emission building and 'G' means the 15% worst-performing building stock. Previously EPCs only required when buildings were constructed, sold or rented out to a new tenant, they must now also be produced after major renovation or renewal of the rental contract.
- 'Major renovation' means, according to member state choice, either

a) The total cost of the renovation relating to the building envelope or the technical building systems is higher than 25% of the value of the building, excluding the land value ; or

b) More than 25% of the surface of the building envelope undergoes renovation

MINIMUM ENERGY PERFORMANCE STANDARDS (MEPS)

Non-residential

- The entire 'G'-class building stock must be at least 'F' by 01.01.2030
- The worst-performing 25% of the building stock must rise by one class level by 01.01.2034

Residential

- The entire residential building stock must reach, on average EPC 'D' class by 2033
- By 2040, a nationally determined value derived from a gradual decrease of the average primary energy use from 2033 to zero-emission in 2050
- ***A member state may choose not to apply the above to single-family houses.*** In that case, those that are sold, rented, donated or whose purpose is changed after 01.01.2028 must achieve at least EPC class 'D' within five years where necessary through renovation by the acquirers or owners.

DEPLOYMENT OF SOLAR ENERGY INSTALLATIONS

- By 31 December 2026, all new public and non-residential buildings with a useful floor area over 250m²
- By 31 December 2027, all existing public and non-residential buildings undergoing a major or a deep renovation with a useful floor area over 400m²
- By 31 December 2029, all new residential buildings

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The exemplary role of public bodies' buildings under the Energy Efficiency Directive

Each member state shall ensure that at least 3% of the total floor area of heated and/or cooled buildings owned by public bodies (central, regional, municipal) is renovated every year to at least be transformed into nearly zero-energy buildings or zero-emission buildings. Where public bodies occupy a building that they do not own, they shall negotiate with the owner, in particular when reaching a trigger point such as:

- Renewal of rental
- Change of use
- Significant repair or maintenance work

with the aim of establishing contractual clauses for the building to become a nearly zero-energy building.

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