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Q&A on Capital Requirements Regulation (CRR) requirements for property valuations

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Overview

In recent weeks, the PRA has received a number of questions from firms in relation to requirements in the CRR for property valuations for residential and commercial real estate exposures. In particular, given the recent disruption in the property market caused by Covid-19, firms have identified difficulties in conducting physical inspections due to social distancing measures, obtaining reliable property valuations and determining appropriate approaches to suspended or unreliable house price indices.

This document answers some commonly asked questions regarding residential and commercial property valuations for CRR purposes during the period of disruption caused by Covid-19. This document will be updated if appropriate as the current situation evolves. New Q&As and updates to existing ones will appear in italics.

Scope

This document is aimed at all firms to which the CRR applies.

Q1. For existing mortgage exposures, what is expected in relation to the monitoring and review of property valuations under CRR Articles 229(1) and 208(3)?

For real estate to continue qualifying as eligible collateral under the standardised approach (SA) and the foundation internal ratings based approach (FIRB), CRR Article 208(3)(a) requires firms to monitor the value of property on a frequent basis. Article 208(3)(b) requires that for loans exceeding EUR 3 million or 5% of the own funds of an institution, the property valuation shall be reviewed by a valuer at least every three years. The valuer must be someone who possesses 'the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process'. Article 229(1) requires that the property valuation be at or less than market value and be determined by an independent valuer.

For existing residential and commercial mortgages, firms should continue to monitor the value of properties. Given the recent impact of Covid-19 on the property market, where it is not possible to review and update valuations as required under Articles 208(3)(b) and 229(1), such as where a physical inspection is necessary but not possible or where evidential data is unavailable, firms can defer the review until the first point at which they can obtain an updated valuation to which they can attach sufficient confidence.

For the avoidance of doubt, CRR Article 229(1) does not require that a physical inspection be conducted as part of the valuation; firms can continue to use desktop valuations and drive-by valuations where appropriate.

Q2. What approach should a firm take if a house price index (HPI) that is used to update property valuations for capital requirements purposes is unreliable or unavailable?

If an HPI used in capital requirements calculations is unavailable or unreliable then firms may use the most recently available reliable HPI until the point at which the HPI becomes available and reliable again. The PRA would not expect firms to use the out-of-date index for more than two quarters. The PRA will keep this guidance under review.

When an HPI forms part of an approved internal ratings based (IRB) approach model, changes to HPI providers need to be submitted to the PRA in accordance with the regulatory technical standards for assessing the materiality of extensions and changes to IRB models.