Recommendation ESRB/2016/14 as amended by Recommendation ESRB/2019/3 on closing real estate data gaps

Questions and answers

Table of contents

Introduction

The aim of this document is to assist technicians with the implementation of Recommendation ESRB/2016/14[1] as amended by Recommendation ESRB/2019/3. It is to be read in conjunction with the Recommendation, but is not an integral part of it and therefore does not impose an “act or explain” obligation.

The document draws on input provided by the Real Estate Task Force (RETF) of the Statistics Committee (STC) of the European System of Central Banks (ESCB) and is designed as a living document that is updated regularly.

Should you require any further clarifications or have specific additional questions, please send an email to **ESRBSecretariat@esrb.europa.eu**.

[1] Recommendation of the European Systemic Risk Board of 31 October 2016 on closing real estate gaps (ESRB/2016/14) (OJ C 31, 31.1.2017, p. 1)

1 Direct and indirect investment

1.1 What is the difference between direct and indirect investment?

The Recommendation requests addressees to report, in countries where investments are deemed to represent a significant share of commercial real estate (CRE), an additional set of indicators on CRE investment exposures, distinguishing between direct and indirect investment.

The difference between the two types of investment can be illustrated with the following examples:

- End-investors (e.g. banks, insurers, pension funds) can buy property directly (direct investment). Direct investment also includes properties owned by investors for their own use. However, properties foreclosed by credit providers as a result of lending operations (as opposed to properties held for the purpose of generating income) are not part of direct investment.
- Indirect investment comprises investments in securities funds, such as funds or real estate investment trusts (REITs), equity investments and holdings of commercial mortgage-backed securities (CMBS).

If a lender or investor uses a special purpose vehicle (SPV) as a dedicated CRE financing technique, such lending or investment should be regarded as direct CRE lending or investment (under the “look-through” approach).

2 Non-performing loans

2.1 How are non-performing loans defined in the context of the Recommendation?

For the purpose of identifying non-performing loans (NPLs), the Recommendation refers to any credit exposures that satisfy either or both of the following criteria: (i) material exposures that are more than 90 days past due; and (ii) the debtor is assessed as unlikely to

pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.

This definition of NPLs is the same as that used in financial reporting (FINREP) under Commission Implementing Regulation (EU) No 680/2014[2].

3 Renegotiated loans in new loans production

3.1 Should renegotiated loans be included in indicators on flows of loans and new loans production?

The topping-up of renegotiated loans (i.e. increasing the size of existing loans) should be included in new production directly – in addition to entirely new loan agreements concluded during the reporting period. By adding the volume of such renegotiation top-ups to the volume of new loans, the gross flow of new loans to the real economy can be determined. However, national macroprudential authorities which are able to distinguish between truly new residential real estate (RRE) loans and renegotiated loans have the option of considering renegotiated loans in a separate breakdown.

4 Bridging loans

4.1 Should bridging loans be included in the calculation of indicators on flows and stocks of loans?

Bridging loans are to be excluded from the reporting. Such loans are defined as non-amortising real estate loans used to facilitate a transaction. For example, they can be used to bridge the gap

---

[2] Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council (OJ L 191, 28.6.2014, p. 1).

between having to pay for a new property and receiving the proceeds from the sale of an existing one or to bridge the gap between a mortgage being granted and the borrower receiving an amount of cash intended for the real estate purchase. In the latter case, it is mandatory that the borrower pledges a property as security against the loan amount. In general, bridging loans do not exceed a maturity of two years and are non-renewable.

5 Calculation of the loan-to-value ratio in the case of senior liens

5.1 How should the loan-to-value ratio be calculated in the case of senior liens?

National macroprudential authorities are recommended to calculate the loan-to-value (LTV) ratio in accordance with Sections 1(2) and 1(3) of Annex IV of Recommendation ESRB/2016/14 as amended by Recommendation ESRB/2019/3.

In addition, if deemed necessary for accommodating national specificities, national macroprudential authorities can also calculate the LTV ratio in accordance with Section 1(4). However, in such cases, they are also expected to calculate it in accordance with Sections 1(2) and 1(3).

6 Value of property

6.1 How should the value of the property at loan origination be determined?

The property value at origination is the lower of the transaction value and market value of the property at loan origination. The market value may be assessed by an independent external or internal appraiser.[3] If only one value is available, this is the value that should be used.

6.2 How should the current value of the property be determined?

The current value of the property is its market value (as at the reference date), as assessed by an independent external or internal appraiser or, if such assessment is not available, as estimated using a sufficiently granular real estate value index or other statistical methods as indicated in the Recommendation. It is to be noted that Regulation (EU) No 575/2013 does not permit the use of statistical methods for determining the current value of the property.[4]

7 Prime property location

7.1 How should a prime location for property be determined?

“Property location” refers to the geographical breakdown (e.g. by regions) or to real estate submarkets, which shall also include prime and non-prime locations. For office buildings, a prime location could be a central location in a major city. For retail buildings, it may be a city centre with large pedestrian flows or a busy shopping centre. For logistics buildings, it could be a location

---

3 For further details on the acceptable valuation methods, see Articles 208(3) and 229 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1) and the Q&As provided by the European Banking Authority, notably 2014_1056 and 2017_3078.

4 ibid.

that has the necessary infrastructure and services, as well as excellent access to transport networks.

A prime location may be determined using, for example, an empirical ex post approach. It is generally considered to be the best location in a particular market, which should also be reflected in the rental yield (typically the lowest in the market). Thus, the lowest decile of properties in terms of yield among properties transacted in a particular period may be classified as prime property. Under this approach, the prime property location should be reassessed on a regular basis.

Another way of determining a prime location is by postcode.

All in all, the reference regions for prime and non-prime locations may be defined the most efficiently by expert judgement of local experts or the sector itself.

8 Property under development

8.1 What is property under development?

The term "income-producing property under development" is used exclusively in the context of CRE financing and includes only property still being constructed which, once completed, is intended to provide its owner with income in the form of rents or profits from its sale.

The term "income-producing property under development" concerns the status of the property during its construction phase only. An essential criterion that needs to be fulfilled for a property to be classified as "income-producing property under development" is that it is intended to produce income. If a property is classified as "income-producing property under development", it is automatically included in CRE.

- The development of rented office buildings and rented business premises is to be included in "income-producing property under development" and, correspondingly, in CRE.
- The development and construction of rental housing by professional developers is to be included in "income-producing property under development" and in CRE, both during the construction phase and upon completion.
- Similarly, social housing is to be included in "income-producing property under development" and in CRE, both during the construction phase and upon completion.
- By contrast, buy-to-let housing constructed by private landlords for the purpose of letting to tenants is to be included in RRE, whether it is already in existence or under construction.

- Similarly, dwellings being constructed by natural persons (e.g. an individual) for their own use (i.e. without the intention of producing income) are not to be included in “income-producing property under development” and should always be included in RRE.

9 Income-producing real estate

9.1 How can banks – beyond the initial assessment – control whether a property is income-producing?

This depends on the local and individual practices of banks. In general, banks tend to review each loan on an annual basis as a sound credit management practice, allowing them to reconfirm the income-producing nature of the CRE.

10 Social housing

10.1 How should social housing be accounted for?

Social housing is to be included in CRE. Moreover, social housing under construction is classified as “income-producing property under development”, since it is being built with the intention of producing income for its owner and should therefore be included in CRE.

A similar approach is also to be applied to loans taken out by a legal entity to fund social housing. Such a loan may be used to acquire an existing property or construct a new one and should be classified as a CRE loan.

If a natural person (e.g. an individual) purchases, for example, an apartment in a social housing property for own use, the status of this particular part of the property would change to owner-occupied RRE, and the loan taken out to fund the purchase would be an RRE loan.

11 Property for dwelling purposes

11.1 How should property for dwelling purposes constructed by a natural person (buy-to-let housing) be accounted for?

Buy-to-let housing is to be included in RRE. Furthermore, where buy-to-let housing represents a significant source of risk stemming from the domestic RRE sector, it is recommended that national macroprudential authorities monitor risks in relation to the relevant indicators separately.

11.2 How should property for dwelling purposes developed by professional developers (rental housing) be accounted for?

Rental housing is to be included in CRE. Rental housing under construction is classified as “income-producing property under development”, since it is being built with the intention of producing income for its owner and should therefore be included in CRE.

A similar approach is also to be applied to loans taken out by a legal entity to fund the construction of rental housing. Such a loan taken out by a legal entity to fund the building of rental housing should be classified as a CRE loan.

If a natural person (e.g. an individual) purchases, for example, an apartment in a rental housing property for own use, the status of this particular part of the property would change to owner-occupied RRE, and the loan taken out to fund the purchase would be an RRE loan.

12 Type of financing as opposed to type of property

12.1 Is the type of property on which a loan is secured sufficient to deduce whether a loan should be a CRE loan or an RRE loan?

The type of property on which a loan is secured is important, but may not be sufficient to determine whether the loan is to be classified as CRE or RRE financing. Indeed, there are other features that are also relevant from a macroprudential perspective. The additional aspects include, but are not limited to, the type of borrower, whether or not income from rental or sale is expected in relation to the property, and whether the lending is for the private rental sector or for social housing.

This is illustrated by the following examples:

- A loan taken out by a sole proprietor (e.g. a general practitioner) for the conduct of his/her business (e.g. to renovate business premises located in his/her own house) and secured by RRE is considered to be an RRE loan.
- A loan taken out by a legal entity (e.g. a professional developer) to finance the building of residential property is considered to be a CRE loan.
- A loan taken out by a natural person (e.g. an individual) to purchase, for example, an apartment for own use is considered to be an RRE loan, as it is being extended to a natural person and is secured by RRE.

12.2 Can a natural person (e.g. an individual) be granted a CRE loan?

No. CRE loans are only extended to legal entities.

13 Valuation method for loans and debts

13.1 How are loans and debts to be valued?

The valuation principles for loans and debts require the use of nominal value and not, for example, fair value. Loans and debts are valued at the amount of principal that the debtor is contractually obliged to repay to the creditor, even where the loan or debt has been traded at a discount or premium. Loans are to be valued at less than nominal value only if they have been written off or written down as wholly or partially irrecoverable. Instruments denominated in foreign currency are to be valued as amounts in national currency converted at the market exchange rates prevailing on the reference date. The value of a loan excludes fees and any other charges. Loans must not be netted against each other or against any other assets or liabilities.

In addition, loans are to be valued on a gross basis, i.e. without regard to any provisions made against them. The same holds for allowances, even if they are not mentioned explicitly in the Recommendation. Any doubt about the debtor's ability to repay should be reflected on the balance sheet only when a loan is written down or written off.

14 Securitised and purchased loans

14.1 How should securitised loans be accounted for?

The Recommendation leaves room for discretion in the treatment of loans securitised or otherwise transferred. In this regard, it may be useful to distinguish between "synthetic" and "traditional" securitisations and other loan disposals.

In the case of a "synthetic" securitisation, the items "loans" and "debts" continue to include the portfolio of underlying loans. In a synthetic securitisation, the economic ownership of the loan is not transferred and remains on the balance sheet of the originating intermediary, which accordingly continues to be the creditor, even if the credit risk is transferred by means of credit derivatives or guarantees which, in effect, insure the originating intermediary against the default of the borrower. The originating intermediary is said to be buying protection on a reference portfolio of underlying assets, while the loan remains on its balance sheet.

In the case of a "traditional" securitisation or other loan disposal, the items "loans" and "debts" continue to include the portfolio of underlying loans when loans are not derecognised and remain on the originating intermediary's balance sheet. In a traditional securitisation or other loan disposal, the loan may be either "derecognised" or "non-derecognised". The loan is said to have been derecognised when it is removed from the balance sheet of the originating intermediary (where this is permitted by accounting and supervisory rules), and the securitisation or other loan disposal is then called a "true sale".

By contrast, the items "loans" and "debts" are computed net of the portfolio of underlying loans when loans are derecognised and are removed from the originating intermediary's balance sheet. In some circumstances, rules do not permit the loan to be removed from the originating intermediary's balance sheet, even in a traditional securitisation. In such cases, the loan transfer is said to occur without derecognition and the non-derecognised loan remains on the originating intermediary's balance sheet.

However, the information may be available through the data of financial servicers (bank or non-bank) or financial vehicle corporations (FVCs). In order to avoid double-counting in countries where this is the case, FVCs should be included in the lender type "others" insofar as they grant loans for their own account or purchase securitised loans that are no longer reported by originating lenders. Thus, in the case of traditional derecognised securitisations, information on stocks of securitised loans may still be used, while this is not the case for loans sold without securitisation.

14.2 How should purchased loans be accounted for?

In the case of loans being securitised or otherwise transferred, the items "loans" and "debts" should include purchased loans. These are to be valued at the principal amount outstanding, excluding amounts written off or written down.

15 Accounting standards

15.1 Which accounting standards are to be followed?

In accordance with the Recommendation, for the compilation of indicators, credit providers should adhere to the accounting standards applicable to them in their country of residence, which will be International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) or national generally accepted accounting principles (GAAP). Where credit providers have discretion to use several accounting standards, IFRS are generally recommended in order to facilitate cross-country comparison.

16 Accrued interest

16.1 Should accrued interest be included?

Accrued interest should be excluded from the loan to which it relates. Even when interest receivable on loans is recorded on the balance sheet as it accrues rather than when it is actually received, it should not be recorded under "loans" or "debts".

17 Repos and reverse repos

17.1 How should repos and reverse repos be accounted for?

The items "loans" and "debts" include the components of repurchase agreements (repos) and reverse repos where these are present. The Recommendation does not require the separate identification of repo-related positions.

18 Statistical and reporting methods

18.1 Is the use of sampling allowed?

The use of sample data, both for lenders and borrowers, is possible, as long as samples are chosen with statistical criteria to assure appropriate representativeness of the domestic real estate loan market. The Recommendation requires information on real estate indicators to be sufficiently representative of the domestic real estate loan market, but leaves to national discretion whether data need to refer either to the entire population of lenders and borrowers of a country or to a sample of them. However, indicators should not refer to subsets of lenders (for example, only large credit providers) and/or borrowers (for example, only large firms) if they are not statistically and significantly representative of the local real estate market as a whole.

18.2 What is the general perimeter and scope of credit providers?

The information on real estate indicators should relate to domestic credit providers on a solo basis and should be sufficiently representative of the domestic real estate loan market. All the types of credit providers that are relevant in the particular domestic market are to be included, e.g. banks, insurance companies, pension funds and investment funds.

The information should relate to domestic credit providers on a solo basis. This includes information on branches of foreign institutions located within the domestic territory.

18.3 Which counterparty geographical location is to be considered?

There are two dimensions: (i) the location of the investor/lender, and (ii) the location of the property used as security for the loan.

Under the Recommendation, "nationality" refers to the country of incorporation of the market participant, and the nationality of investors and lenders should be broken down into at least the three following geographical categories: (i) domestic; (ii) European Economic Area; and (iii) rest of the world.

Furthermore, the indicators on both RRE and CRE financing should also include information on loans secured by property located in the domestic territory as well as abroad.