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EAA TECHNICAL NOTE I

General Principles for Comparables Based AVMs to arrive at the Property Value



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Background

On 21 June 2024 Regulation (EU) 2024/1623 (CRR3) was published in the Official Journal of the EU, implementing the final of the Basel III Reforms and thus replacing the current CRR (EU) 575/2013.

Two of the key changes to the current provisions are

- the introduction of the property value regarding the valuation of residential and commercial property, and
- the introduction of advanced statistical and mathematical models, their use and characteristics into first tier legislation.

The new rules in both areas are to be applied from 1 January 2025 onwards.

The European AVM Alliance, representing the leading providers of Automated Valuation Models for the valuation of residential property operating within the European mortgage lending industry, has determined general principles for the use of suitable Comparables Based AVMs to arrive at the new property value in full compliance with the new provisions in CRR3, and in particular with Articles 208 and 229.

These general principles are intended to help banks, lenders, rating agencies, as well as regulators and legislators on EU and national level to finalise their preparation for the continued use of Comparables Based AVMs and under the new CRR provisions and to be compliant and operational by 1 January 2025.

Valuation principles for residential property using Comparables Based AVMs

The Comparables Based AVMs in the EAA produce market values for residential properties and will continue to do so.

Although Article 229 introduces a new concept of the property value (which should be arrived at by an independent valuer using prudently conservative valuation criteria ("property value")), and although the established concepts of market value and mortgage lending value in the context of CRR3 will no longer be permissible as stand-alone concepts for the property valuation principles, Article 229 still includes key operational references to market value in the context of determining the property value.

In the EAA's expert view, the market value will remain the best, most reliable, and most appropriate basis for the determination of the property value, since the market value is a well-established and well-understood concept across the entire mortgage and property lending industry in Europe and beyond, and because the accuracy of producing a Market Value can be tested in an objective manner.

Therefore, from Comparables Based AVMs, property values can be produced independently from an institution's mortgage acquisition, loan processing and loan decision process that are compliant with the requirements set forth in Articles 208 and 229 of CRR3 by using the market value as a basis and making the necessary adjustments using prudently conservative valuation criteria.

Comparables Based AVMs thereby adhere to the following valuation principles for the valuation of residential property:

- 1. the market value as defined in Article 4 (76) of CRR3 is produced for a residential property by the Comparables Based AVM;*
- 2. this market value is used as a basis for the resulting property value;*
- 3. expectations on a price increase are excluded in the resulting property value;*
- 4. adjustments are made to the market value, or derived from calculations of the market value, for the resulting property value which take into account the potential for the current market value to be significantly above the value that would be sustainable over the life of the loan;*
- 5. the resulting property value and how it is arrived at is documented in a transparent and clear manner;*
- 6. the resulting property value is not higher than the market value (except in cases which fulfil the conditions in Article 229 (1)(d) of CRR).*

Additional valuation principles for residential property in the context of revaluation in CRR3

Beyond the general valuation principles, there are additional requirements to be applied for revaluation in Article 229 (1)(e) and thus further adjustments to the market value need to be made to arrive at the property value for revaluation:

- the property value for revaluation does not exceed the average value measured for that or a comparable residential property over the last six years, or the value at origination – whichever is higher;
- this average value against which the property value needs to be compared, is calculated by taking the average across the property values observed at equal intervals in time, and the reference period includes at least three data points.

Comparables Based AVMs adhere to the following additional valuation principles for the valuation of residential property in the context of revaluation:

7. *the average value against which the resulting property value for the purpose of revaluation is compared, is calculated using the results of the monitoring provided by the Comparables Based AVMs as prescribed in Article 208 (3) and (3a);*
8. *to calculate the average value the average across the property values observed in equal intervals is taken, and the reference period shall include at least three data points;*
9. *the resulting property value for revaluation does not exceed the average value measured for that or a comparable residential property over the last six years, or the value at origination – whichever is higher;*
10. *in derogation to 9. the resulting property value may exceed the average value/value at origination in case of modifications made to the residential property that unequivocally increase its value (such as improvements of the energy performance or improvements to the resilience, protection and adaptation to physical risks of the residential property);*
11. *in case no average value can be determined due to insufficient data, the resulting property value can only be valued upward if 10. is fulfilled;*
12. *In addition, Comparables Based AVMs can take into account the conditions that are specific to each market/jurisdiction when applying these general principles to arrive at the property value.*

Full compliance of Comparables Based AVMs with Article 208 of CRR3

Comparables Based AVMs in the EAA are fully compliant with all of the following conditions, characteristics and provisions regarding advanced statistical and mathematical methods ("models") in Article 208 (3a) of CRR3 which must all be fulfilled to be used for monitoring the value of immovable residential property and to identify the immovable residential property in need of revaluation: ¹

- the models in the EAA have been developed independently from the credit decision process;
- the models in the EAA fulfil all of the following conditions:
 - the institutions using the models of EAA members set out, in their policies and procedures, the criteria for using models to monitor the values of collateral;
 - the institutions using the models of EAA members set out, in their policies and procedures, the criteria to identify the properties that should be revaluated;
 - those policies and procedures account for these models,
 - proven track record;
 - consideration of property-specific variables;
 - the use of minimum available and accurate information;
 - uncertainty;
 - the institutions ensure that the models used are
 - property and location specific at a sufficient level of granularity;
 - valid and accurate, and subject to robust and regular back-testing against the actual observed transaction prices;
 - based on a sufficiently large and representative sample, based on observed transaction prices;
 - based on up-to-date data of high quality;
 - the institutions are ultimately responsible for the appropriateness and performance of the models;
 - the institutions ensure that the documentation of the models is up to date;
 - the institutions have in place adequate IT processes, systems and capabilities and have sufficient and accurate data for any model-based monitoring of the value of immovable property collateral and identification of properties in need of revaluation;
 - the estimates of models are independently validated and the validation process is generally consistent with the principles set out in Article 185, where applicable.

¹ Comparables Based AVMs are the only models using advanced statistical and mathematical methods that fulfil all of the conditions set in Article 208 (3a). The adherence of the Comparables Based AVMs in the EAA to the highest and most advanced technical requirements and the continuous monitoring of their performance are certified through the EAA AVM Label and the European Standards for Statistical Valuation Methods for Residential Property, 3rd edition, 2022; ISBN 978-2-9602973-0-0.



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