RICS PRACTICE INFORMATION

# Bank lending valuations: Basel 3.1 prudently conservative valuation criteria adjustments

Global

1st edition, October 2025

RICS®

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| Document type | Definition |
|---|---|
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| **RICS practice information** | **Information to support the practice, knowledge and performance of RICS members and regulated firms, and the demand for professional services.**<br><br>Practice information includes definitions, processes, toolkits, checklists, insights, research and technical information or advice. It also includes documents that aim to provide common benchmarks or approaches across a sector to help build efficient and consistent practice.<br><br>This information is not mandatory and does not set requirements for RICS members or make explicit recommendations. |

# 1 Introduction

## 1.1 Scope and application

This practice information is primarily directed at those providing valuation services for bank lending purposes. While designed for reference by RICS members, it may also assist users and other stakeholders – borrowers, lenders and regulatory authorities – to understand the underlying issues.

This practice information addresses the Basel 3.1 Accord prudently conservative valuation criteria and their possible impact on bank lending valuations. It supplements the current edition of RICS' Bank lending valuations and mortgage lending value, which focuses on the provision of mortgage lending value under the regulations of the EU.

This practice information discusses in detail the concepts and bases of valuation for bank lending purposes, the impact of the Basel 3.1 guidance on financial regulation and the implementation of the Basel 3.1 guidance globally, which contains additional property valuation criteria. This practice information focuses mainly on the discussion around the implementation of Basel 3.1 globally.

As this document relates to ongoing discussions around the meaning of the new Basel 3.1 criteria and contains guidance to valuers rather than instruction, it has been issued as practice information and not a professional standard. This reflects the variable nature of the implementation of changing regulations globally.

Europe has been at the forefront of discussions around the new Basel 3.1 criteria. Other jurisdictions have either specifically excluded prudently conservative valuation criteria from their Basel 3.1 implementation or have decided it does not change their expectations around the provision of valuations at either loan origination or for monitoring. Valuers working in different jurisdictions are obliged to comply with the financial regulations appertaining to property valuations within that jurisdiction (RICS Valuation – Global Standards (Red Book Global Standards), PS 1, section 4).

'Prudent value' has been used to describe the new Basel 3.1 criteria, but prudent value is a recognised term within financial regulatory guidance for the fair valuation of assets (see CAP50 – Prudent valuation guidance). The prudently conservative valuation criteria applied to real estate valuation do not appear in this form of prudent value, so this practice information does not use the term prudent value.

Basel 3.1 refers to the 'value of the property' and the recently amended European Union Capital Requirements Regulation (EU) No 575/2013 (CRR III) refer to the value using prudently conservative valuation criteria as the 'property valuation'. For the avoidance of any confusion, this practice information uses the term 'prudently conservative valuation criteria'

or 'prudently conservative property value/valuation' when the valuation utilises the Basel 3.1 criteria.

## 1.2 Context

Red Book Global Standards, VPGA 2, paragraph 1.1 states that:

> 'Valuation practice, process and regulation for secured lending often has particular differences depending on the jurisdiction and asset type. Reference should therefore be made to relevant secured lending coverage in RICS national supplements, jurisdiction guides and any other relevant RICS or other professional standards and best practice guidance, in addition to adhering to local laws and regulation.'

Adhering to regional, national or local regulation or guidance is particularly pertinent to valuations for secured lending purposes, as different jurisdictions globally have not regulated in the same way or have put different interpretations on the same regulations or guidance.

This practice information provides principles for valuers tasked with providing lending valuation advice, but regional or national regulation and guidance takes precedence where it conflicts with these principles. Any valuation following a process or method set out in such regulations is not outside Red Book Global Standards (see PS 1, section 4). Many jurisdictions are still forming their response to the ever-changing regulatory environment, and valuers should be aware of both current and future regulation or guidance to be followed.

Market value is the primary definition of value for bank lending purposes. Red Book Global Standards, VPGA 2 states the following.

> 'Market value is the basis of value widely used for valuations or appraisals undertaken for secured lending. However, in some jurisdictions alternative bases may be recognised or expressly required, for example, as a result of statute or regulation, 'mortgage lending value' being one example. These alternative bases may, and often do, involve prescribed approaches or assumptions and may therefore result in a value for the purpose of secured lending that is quite markedly different from market value as defined in IVS 102 paragraph A10.01 and reproduced in VPS 2. While valuers can provide advice using these alternative bases of value, what is essential is that the particular basis of value adopted is always made clear.'

RICS advice is that market value remains an important and integral component of any assessment of the security of any individual property for secured lending purposes. Where an alternative basis or concept method of valuation is used, Red Book Global Standards does not mandate that market value is provided in all cases. However, where other definitions of value are used, RICS advises that they should be benchmarked against market value.

In the aftermath of the global financial crisis (GFC), market valuations have been criticised as the sole basis of valuation for bank lending purposes. Post GFC, the banking process came

under increased scrutiny at global, regional and national levels. Regulatory authorities have discussed various methods by which they can introduce measures to address significant problems identified in the banking system and help to prevent future failures. The valuation of real estate is one area among many that has come under scrutiny in this period.

Valuations are an important part of the lending process, both at the commencement of the loan and during the life of the loan. In rising markets, lending risks may appear to reduce. But when subsequent significant property market downturns lead to loan amounts exceeding realisable values on a widespread scale, as occurred during the GFC, the banking system comes under severe stress. It is the loans granted in the last few years of a rising market that are the loans most likely to fall into technical default. The GFC exposed some serious weaknesses, which were not confined to those banks that failed.

Some governments bailed out their failing banks at a major cost to their taxpayers. It is therefore not surprising that the role of property and property valuation in the bank lending process is being scrutinised by regulatory authorities and central banks, with the major objective being to ensure secured lending is based on sound principles and processes that counter any behaviour that leads to unsustainable lending in markets that may be over-priced.

In this context, the market value basis of valuation has been described as pro-cyclical (encouraging increased lending in a strong market upcycle and restricting lending in the period after any major downward correction – see section 2).

Alternatives or adaptations to the existing approaches are sought, including within the Bank for International Settlements (BIS), whose supervisory chapter (the Basel Committee on Banking Supervision (BCBS)) provides global guidance on financial regulation (the Basel 3.1 Accord). Although guidance, many jurisdictions have adopted Basel 3.1 in financial regulations.

This practice information identifies these alternatives or adaptations by discussing the wider context of alternative approaches including mortgage lending value, and provides some more detailed high-level guidance on the application of the prudently conservative valuation criteria contained in the Basel 3.1 Accord, which is the BCBS' response to the property valuation issue. The specific application of mortgage lending value within Europe is dealt with in the current edition of RICS' Bank lending valuations and mortgage lending value.

The nature of the valuation and the role of the valuer, including whether interpretation of the Basel 3.1 criteria are within that role, are important issues for discussion in this practice information.

# 2 Concepts and definitions of value for bank lending purposes

Before any alternative methods of valuation can be developed, they need to be put into the context of the different concepts of valuation and the specific basis of market value.

## 2.1 Market value

The primary approach is market valuation. The definition of market value as set out in the International Valuation Standards General Standards (IVS, 2025) and Red Book Global Standards is:

> 'the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.'

It represents the best estimate of the expected price to be agreed in the market at the date of valuation and holds no explicit information regarding the price at any other date or period. It obviously contains implicit information regarding the future expectations of purchasers and sellers but that is not explicit in the valuation, and any assumptions that the valuation remains valid throughout the life of the loan are erroneous.

There are variations of market value within bank lending that generally come under the banner of assumptions or special assumptions. These valuations are all market valuations in that they are observations of estimated prices subject to those assumptions. They are usually approached via an adjustment to the market valuation for the impact of the assumption or special assumption. These adjustments are based on the experience of the individual valuer.

The accuracy of market valuation is often measured by reference to how closely it matches any corresponding transaction price, and an accurate valuation will therefore relate to how closely it matches changing prices. Market prices are cyclical and can be different from any notion of the underlying intrinsic or economic fair value of the asset.

This is recognised in international valuation standards, and an alternative definition of 'investment value' has been formed, which seeks to identify the worth of an asset to a specific entity rather than its market price. Previous definitions of investment value included the concept of worth to a group of investors rather than a single investor, which is particularly pertinent to this discussion. The fact that economic fair value or worth to the market does not always equal price is a well-established concept within real estate markets.

Despite the discussions surrounding the appropriateness of market value as the sole basis of valuation for lending purposes, in jurisdictions that have implemented Basel 3.1 but not amended their valuation expectations for the new criteria, market valuations would be expected to remain the sole method applied to valuations required during the lending process.

## 2.2 Long-term value

In the context of bank lending valuations and in the wake of the GFC, stakeholders globally within the real estate lending process identified weaknesses in the use of market value as the sole basis of valuation. As indicated in section 1, in a booming real estate market prices rise, and these prices will be used to justify higher valuations, which in turn will justify higher lending levels (in the absence of any counter-balancing changes to loan-to-value ratios within lending criteria). Loans originated in the final phase of the property price boom will go into default.

There have been a number of attempts both before and after the GFC to introduce alternative concepts and methods of valuation. The longest and most well-established of these is mortgage lending value.

## 2.3 Mortgage lending value (MLV)

As market value has no time frame attached to it other than at the date of valuation, alternative valuation techniques attempt to bring a longer-term perspective to the valuation to add some additional security over the lifetime of the loan. Mortgage lending value (MLV) is one interpretation of a longer-term sustainable value.

Long-term value is not currently defined in international valuation standards, but MLV has been used in a number of countries within Mainland Europe and has its origins in Germany. It is a heavily prescribed method of valuation dating back to the turn of the 20th century and the German *Mortgage Bank Act* (*Hypothekenbankgesetz*) of 1900. With the increasing amount of cross-border investment and lending, this method of valuation is required in a number of countries across Europe.

The MLV concept was first introduced in the EU by the Banking Directive of 2006 (Directive 2006/48/EC, Annex VIII, paragraph 64) and was subsequently taken up by European Union Capital Requirements Regulation (EU) No 575/2013 (CRR III). Those regulations have been amended from 1 January 2025 by Regulation (EU) No 2024/1623. Whereas MLV applied to property valuation for both lending and funding purposes in the past, its role was realigned by the CRR Regulation (EU) No 2024/1623 to property valuation for funding purposes through the issuance of covered bonds.

However, some EU countries will continue to apply MLV for lending purposes as well, on the basis that MLV could be considered to comply with the prudently conservative valuation criteria principles of CRR III. The definition of MLV in CRR III, Article 4(74) was retained:

> '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.'

The principles of the application of MLV are set out in the current edition of RICS' Bank lending valuations and mortgage lending value.

The EU implementation of Basel 3.1 includes provisions that impact on the application of MLV across Europe, and the EU CRR III have been amended accordingly. Until its amendment, Article 229 of the previous CRR referred to market value and MLV for property valuation for lending purposes allowing credit institutions to benefit from a preferential risk weight treatment of collateralised mortgages. Both approaches were replaced by the conservative 'property value' as defined in CRR III, Articles 4(74a) and 229(1).

As regards the valuation of real estate cover assets for the issuance of covered bonds, competent authorities may allow that such assets continue to be valued at the market value or the MLV in those Member States that have laid down rigorous criteria for the assessment of MLV in statutory or regulatory provisions (CRR III, Article 129(3)).

Credit institutions could decide to use MLVs for bank lending as well, as long as they comply with their domestic regulation. In such cases, the MLV becomes a property value in accordance with Article 229 of CRR III. Given the prescriptive nature of MLV, a property valuation using the prudently conservative criteria cannot be presented as an MLV.

MLV can take a number of different forms across the EU. Basel 3.1 includes mention of the use of MLV for loan-to-value calculations for covered bonds but does not define it or suggest any criteria. These depend upon national regulations or custom and practice.

There are transitional arrangements in CRR III for the monitoring of existing portfolios. After implementation in January 2025, market value or MLV can be used until a review of the property value is required in accordance with Article 208(3) of CRR III or until 31 December 2027, whichever is earlier (CRR III, Article 495f). After that the new Basel 3.1 prudently conservative valuation criteria apply.

## 2.4 Alternative long-term valuation methods

Post GFC, the limitations of both market value and MLV have been increasingly exposed and a wider interpretation of long-term value sought. Although no definitive method of long-term valuation has yet been developed, there is an increasing body of research and development into both the concept and how that concept could be applied in practice.

A number of long-term value concepts have been developed within the academic literature on real estate markets. Long-term value does not mean that the value of the property will remain static through time. Long-term valuations are dynamic and are accompanied by a date of valuation.

Based on that research, there are three different concepts of value, set out in Figure 1.

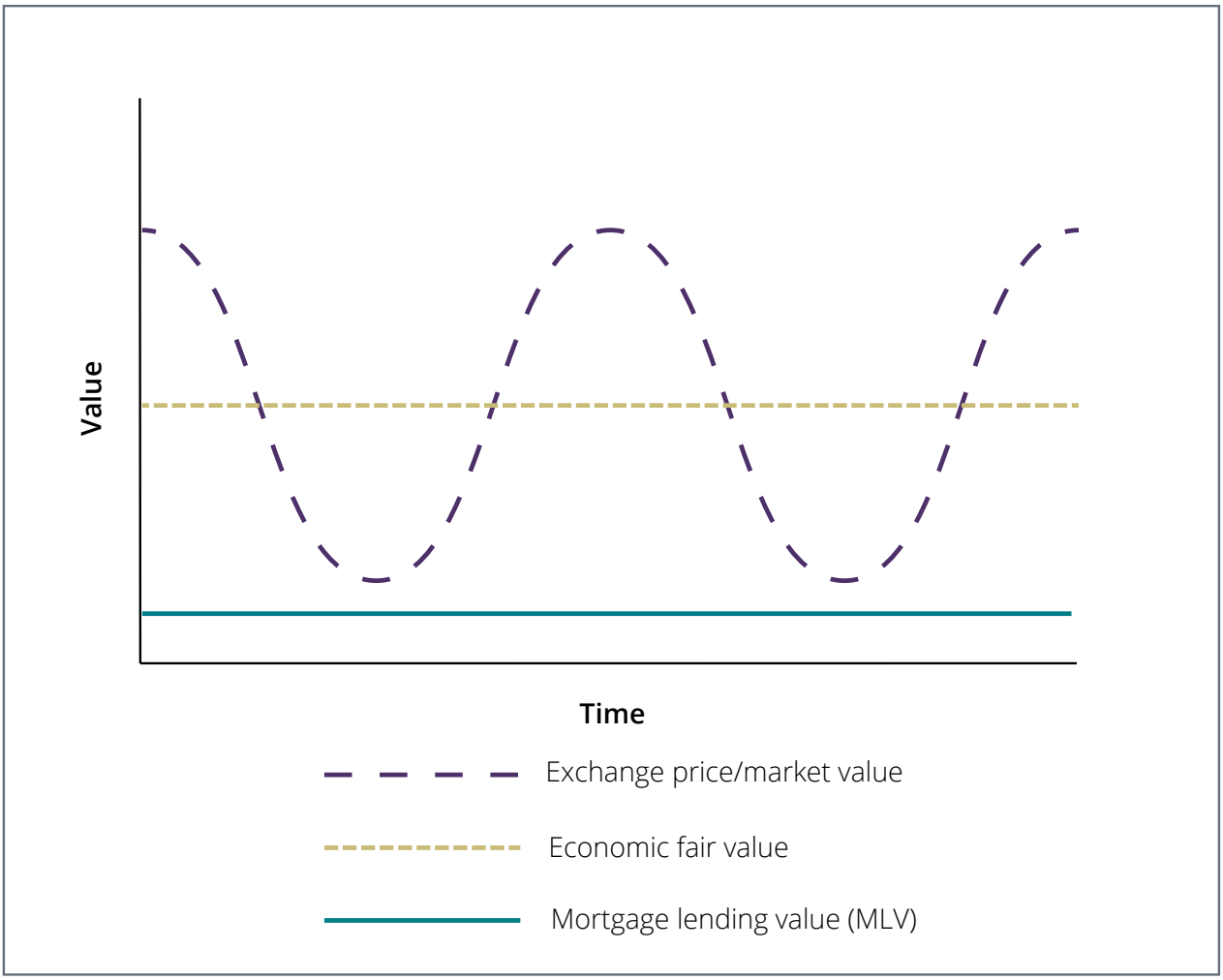


Figure 1: A stylised view of the different approaches to long-term value

Market prices are represented by the cyclical movements in price, and the definition of MLV has been characterised as an under-the-cycle model whereby the outcome is always less than market value.

This is a very simplified view of the way in which different concepts work through time. Property prices tend to change more gently in an up-cycle rather than in a downturn, and in nominal terms, values tend to rise in inflationary economies. Some properties are more subject to obsolescence and depreciate in value faster than others. None of the values are static through time in either real or nominal terms.

Figure 2 illustrates this by tracking hypothetical MLV, market value and one version of long-term value using UK All Property indices from research undertaken into long-term values by the UK real estate industry during the period 2015 to 2020 (IPF long-term value methodologies in commercial real estate lending (July 2020)).

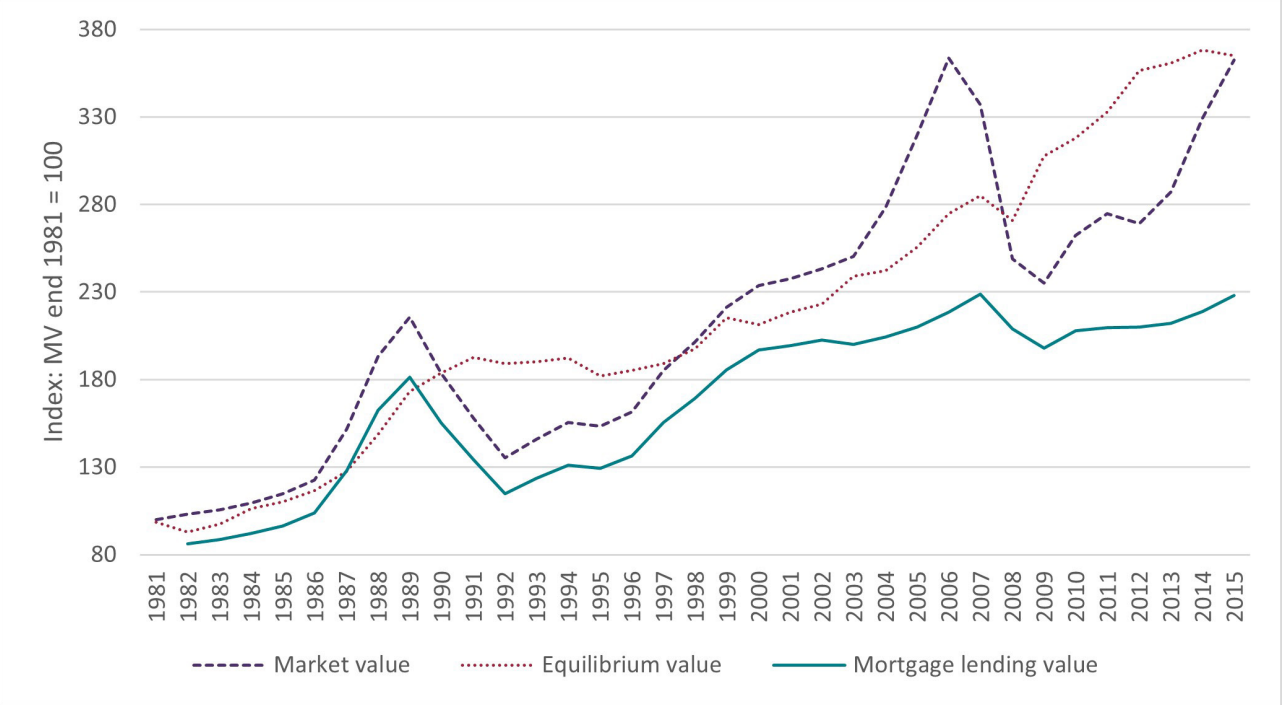


Figure 2: Market value, mortgage lending value and equilibrium value: end 1981 to end 2015 (UK All Property End 1981, market value MV = 100). Source: based on data from the Investment Property Forum Research Programme long-term value research IPF long-term value methodologies in commercial real estate lending (July 2020) full report
Note: Although reported in nominal terms, analysis of past trends is normally assessed in real terms. In this case, UK inflation was added back to represent the values in nominal terms.

Post-GFC research has investigated alternative long-term value methods other than the prescribed German version of MLV.

In 2017, the BCBS published the Basel 3.1 Accord, which contained prudently conservative valuation criteria. More recently the research and development has concentrated on how these Basel 3.1 prudently conservative valuation criteria map onto these alternatives (Basel III: Finalising post-crisis reforms).

The long-term value that has received the most attention in this post-GFC period represents a through-the-cycle model, and this has been characterised as trying to find the true underlying economic value of the asset. It has its origins in equilibrium value theory.

Research on long-term modelling has developed through three major questions.

First, studies investigated the currently accepted concepts and definitions of value within valuation standards: market value, MLV and investment value. Specifically, could investment value have a role in the bank lending valuation arena to address the concerns over market value and MLV? Using UK long-term past data and forecasts of future growth, this research found that while simple cash flow modelling using risk adjusted discount rates, five-year rental growth forecasts and long-term average exit yields would have provided an excellent

predicter of the 2007 UK market downturn as early as 2004/5, it failed to identify the previous 1990 downturn in the UK. This failure was related to the inaccurate medium-term forecasts of rental growth used in cash flow models at the time.

In summary, the discounted cash flow model using forecasts failed to identify an impending rental market collapse, although it did identify a capital market downturn.

The second element of the research, prompted by the preliminary research results set out above, investigated other possible through-the-cycle models that could give early warning of excessive cyclical movements in property markets. This research programme, still using UK data (as this is the market with the longest running property market database) found that basic past trend modelling is enough to identify major cyclical movements. But it also found that better results can be produced with more sophisticated economic modelling, where the data allows.

In summary, there is a body of market analysis methods that enables a long-term through-the-cycle approach to be applied to past property market data to find when markets are over- or under-priced (see IPF long-term value methodologies in commercial real estate lending (July 2020) full report).

A third strand of the research has focused on whether these results have any application to the Basel 3.1 prudently conservative valuation criteria. The findings are that the prudently conservative valuation criteria are fully addressed by the use of long-term market analysis modelling and can be used to supplement an individual property market valuation (see Crosby, N. and Hordijk, A., Approaches for prudent property valuations across Europe, 2021 and Crosby, N. and Hordijk, A., The implementation of long-term prudent valuation models across the UK and Mainland Europe for financial regulation purposes (March 2023) report, funded by the Investment Property Forum Research Programme and Property Research Trust).

Section 3 details the Basel 3.1 criteria and how they could be implemented globally.

RICS played an active part in sponsoring and supporting this research-led approach, and based on that research concluded that the Basel 3.1 criteria require a different approach to that adopted within both existing bases of valuation (market value and MLV).

Market value and MLV can be applied at an individual property level and are independent of each other. Market value requires market evidence and MLV requires some additional level of prescription.

**The Basel 3.1 prudently conservative valuation criteria require an adjustment to market value. The adjustment should be based on a market-wide analysis rather than an individual property perspective.**

The reasons for this distinction between an individual property's market value/MLV and the market-wide approach to the implementation of prudently conservative valuation criteria are set out in section 3.

# 3 Basel 3.1 prudently conservative valuation criteria

## 3.1 The criteria

The first Basel 3.1 prudently conservative valuation criterion is 'to ensure that the value of the property is appraised in a prudently conservative manner, the valuation must exclude expectations on price increases'. As there is no explanatory text to accompany the criteria the reasons for and meaning of each criterion have to be assumed.

It is difficult to see how this criterion can lead to any adjustment to a competent market valuation. Taken literally, this criterion specifically excludes positive growth expectations but not forecasts of value falls. This is a major issue as most prices are based on the expectations of purchasers, and in property it could be argued that much of the current price includes expectations of income and asset growth. It could also be assumed that the objective is simpler and that they wish to exclude any explicit increase in the valuation at the date of valuation that could only be expected to be realised later. As this is excluded from any competent market valuation, it does not warrant an adjustment from any market valuation estimate.

Another explanation could be the exclusion of any additional value from prospective changes in use or physical changes such as redevelopment or refurbishment.

Alternatively, it might be that it is related to asking prices being above provable market prices. This would be ignored in a competent market valuation, so again it is difficult to see how this criterion affects a market valuation, or changes it.

The intention is surely to restrict the valuation to a figure that takes no account of unreasonable or economically unrealistic current price levels.

The second criterion is more in line with this approach. It states that the valuation 'must be 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'. This fits with the intention above as it states 'significantly above' rather than just above.

This criterion identifies the importance of the length/remaining life of the loan within lending. However, a through-the-cycle long-term trend approach does not take into account the future unexpired term of the loan. The method looks at the current market value and where that value sits relative to past trends in the property market data. As the adjustment is from a current market value to the long-term value at the date of valuation, the length of the unexpired period of the loan becomes irrelevant to the adjustment factor, which assumes the adjustment would take place immediately.

A further practical limitation is that the loan period is not always provided in the lender instructions or allowed to be shared with the valuer.

This does raise the question of what the prudently conservative valuation criteria mean for properties where there is a prospect of a cyclical trough in the future below the equilibrium, long-term value within the loan period. As indicated above, the term significantly above the sustainable value assumes some context to a temporary and an economically 'unsustainable' low or high market value/price. So, as a through-the-cycle long-term value does not forecast any prices that may fall below equilibrium or long-term value at any point in the future, an element of risk does remain.

The definition of property value under the Basel 3.1 criteria also includes two other criteria.

The third criterion is that 'National supervisors should provide guidance setting out prudent valuation criteria where such guidance does not already exist under national law' and the fourth is that '[i]f a market value can be determined, the valuation should not be higher than the market value'.

The fourth criterion makes market value a prerequisite for the prudently conservative property valuation, and the prudently conservative valuation criteria can be accommodated by an adjustment to the market valuation where it is appropriate. Where prices are below long-term values, for example after a major downturn, the Basel 3.1 criteria imply that the market value will become the property valuation rather than the adjusted market valuation.

This reinforces the guidance that market value should be part of every valuation report undertaken for bank lending purposes. In applying the Basel 3.1 criteria, stating the market value is an essential part of the valuation process.

**As a through-the-cycle assessment can be both above or below market value, applying the prudently conservative valuation criteria means the property value is either market value or long-term through-the-cycle value, whichever is lower.**

The responsibility for setting the rules will be the national supervisors', as indicated in the third criterion. A number of national or regional jurisdictions have pronounced on their interpretation of the prudently conservative valuation criteria, many have not, and there is no global consistency in those pronouncements. A number have implemented Basel 3.1 but not changed the property valuation process.

This makes it very difficult for valuers working within or across different jurisdictions to identify their role, if any, in applying the criteria. But valuers should identify how the Basel 3.1 financial guidance has been implemented and interpreted before accepting any instruction to value property for lending purposes in that jurisdiction.

Section 3.3 addresses the role of the individual valuer in providing bank lending valuation advice.

## 3.2 How might the criteria be implemented?

### 3.2.1 Principles

The implementation of the criteria above requires the identification of circumstances when property prices, estimated in the individual property market valuation, are in danger of breaching the prudently conservative valuation criteria as set out in Basel 3.1.

If there are issues attached to the individual property that give rise to concerns as to its suitability as security for any loan they should be picked up and commented upon during the market valuation process. **The market valuation process satisfies the criteria for an independent valuer and valuation.**

An independent valuation within the Basel 3.1 criteria is defined as one that 'must be done independently from the bank's mortgage acquisition, loan processing and loan decision process' (Basel III: Finalising post-crisis reforms, Footnote 40). This does not necessarily require an external valuer.

Issues that are fundamental to financial stability are not based on characteristics of the individual property, which in any case will have been addressed in the market valuation report. Financial instability comes from lending the wrong amount at the wrong time to a sector as a whole. It therefore follows that the solution should be aimed at the market sector as a whole.

Virtually all of the research into solutions has found that adjustments to individual market valuations should be based on market sector or segment analysis using long-term trend models, i.e. at a high level of aggregation of property assets.

Individual valuers determining individual adjustments to individual property market valuations would create significant variation across the sector as a whole and not provide lenders with consistent advice regarding cyclical movements in property prices. It would require individual valuers to determine when markets were over-priced, and many valuers undertaking bank lending valuations do not have either the expertise or the data to make that judgement. Some do, and they may well identify adjustments earlier in a boom scenario than those who do not. This inconsistency will give lenders and regulators conflicting advice, cause confusion and not give any stakeholders confidence that the process adds anything to financial stability. It will also open up individual valuers in some jurisdictions to professional negligence claims from lenders in the event of another major downturn.

To avoid these problems, where national regulators or lenders do not provide the guidance and rely on valuers for both the market valuation and the adjustment, international and national valuer associations will need to provide the adjustment factors for their membership.

Adjustment factors should be research led and developed in conjunction with regulators, lenders and valuers, and the existing research has provided a template for the approach.

This template varies for different countries, mainly based on different levels of data quality and availability within property and other markets.

### 3.2.2 Methods

As indicated above, the first step in a property valuation under the Basel 3.1 criteria is a market valuation at the individual property level, which is required to identify any asset-specific issues that impact on value (location, tenure, occupation, building quality, etc.), notwithstanding the need to verify the asset actually exists (to insure against fraud). Basel 3.1 states that the valuation should be an independent valuation.

The European Central Bank, in its 2024 publication Commercial real estate valuations: insights from on-site inspections, has addressed the new criteria and has suggested that 'this change does not imply that a completely new valuation approach is needed, but it does introduce key new requirements to ensure a prudent and conservative value assessment.' It further states that 'the requirement for an independently determined market value remains.'

In terms of implementation, it suggests that the EU CRR amendments require lenders to maintain data on property values through time and use this data 'to consider whether the market value should be subject to a haircut'.

They therefore acknowledge both the approach and the need for long-term datasets to address the Basel 3.1 criteria.

These long-term datasets are not published or publicly available at the individual property level but are usually published at a market segment level within individual countries. The amount and quality of the long-term data within real estate markets is extremely variable from one country to another. Appendix A lists countries grouped by market maturity based on JLL's The global real estate transparency index 2024. One of the major factors within this listing is data quality and availability.

The most mature market is listed as the UK, and this country has been used as the main case study to test the effectiveness of a variety of different quantitative models measuring long-term property market trends.

Having established that a cash flow model using forecasts of income growth did not pick up disequilibrium in occupier markets, other trend models tested against the last two major downturns in the UK property market all showed that they could be adapted to identify markets trading at prices above their long-term equilibrium. This included a range of models from a basic past trend to an econometric model using an array of property market and demand-side and supply-side data.

Although the more sophisticated and data-hungry model provided the best results, the basic trend model passed the test of identifying a potential major property market correction with at least two years' warning. The more sophisticated models require a range of economic, financial and property market data. However, a basic long-term trend model would

require around 15 years' worth of past property market data on rental value change and capitalisation rates or capital value change.

Market level adjustment factors raise the question of the amount of disaggregation required. Although different property types and locations perform differently, the shape of value change and the timing of booms and busts are similar, suggesting that over- and under-pricing is a wider property market phenomenon, rather than a property market segment issue. This implies that even a single all-property adjustment factor by country could provide a basis for the adjustment. However, some level of disaggregation where data sources allow would improve the effectiveness of any modelling. It should also be noted that the aim of the adjustment is to protect the loan books of lenders and that the performance of random individual assets within the loan book are not the cause of any widespread failure that leads to financial instability.

The timing of any publication of adjustment factors would have to be short enough to stay relevant. The research in the UK suggested every six months should be sufficient.

Appendix Bsets out some different potential approaches for the determination of adjustment factors. They are for guidance only. Appendix Balso addresses the data issues raised by these potential solutions to the application of the Basel 3.1 criteria and the determination of adjustments to market value.

Implementation is dependent upon the response of national jurisdictions to Basel 3.1 in general and the prudently conservative valuation criteria in particular. The next section addresses regional and national differences.

### 3.2.3 National implementation of Basel 3.1

Under Red Book Global Standards, PS 1, section 4, any national or regional legislation takes precedence over any valuation standards where they differ.

Appendix C sets out the state of implementation of Basel 3.1 globally as indicated by the Bank for International Settlements' dashboard for Basel 3.1 implementation as at Q3 2024. This dashboard relates to 19 individual countries plus the EU, representing in total 46 countries. Of those, only ten have fully implemented Basel 3.1: Mexico in 2021; Australia, Brazil, Canada, Indonesia, Saudi Arabia and South Korea in 2023; and China, Japan and Singapore in 2024.

The EU implemented Basel 3.1 within its revised CRR III on 1 January 2025, with a phased implementation to 2030, along with Switzerland, which also implemented it on 1 January 2025.

The UK has delayed implementation until January 2027, again with a phased implementation to 2030. At the time of writing, the new Trump administration in the US has not yet decided on the 'Basel III Endgame'.

This shows that many countries are well advanced in the implementation of the Basel 3.1 standardised approach for credit risk that includes the references to the prudently

conservative valuation criteria. However, no jurisdiction appears to have set out its interpretation of the specific prudently conservative valuation criteria. Apart from the UK and the EU, there is no evidence of any discussions about whether the Basel 3.1 valuation criteria impact on the valuation landscape within these jurisdictions.

The UK, despite having the most significant research base to enable it to implement the prudently conservative valuation criteria, is the one country that has decided not to implement the main prudently conservative valuation criterion that does not accord with market value, while planning to implement most of the other Basel 3.1 guidance. The basis of valuation for bank lending purposes therefore remains market value in the UK.

Valuers in a jurisdiction that has not adopted the Basel 3.1 criteria could be asked to apply it in that jurisdiction by foreign lenders from jurisdictions that have adopted the criteria.

The EU has amended its CRR III for the Basel 3.1 Accord. In those 27 countries, unlike in the UK, all four prudently conservative valuation criteria remain as the criteria for the valuation of property assets. The EU has not provided any further guidance for implementing the criteria. However, it has provided some detail of how it expects banks to monitor their property exposures, and this also requires some long-term property data.

The role of the different stakeholders concerning the property valuation criteria in Basel 3.1 is unclear, and that creates a major issue for the valuation profession, in particular the role of the valuer in implementing the criteria.

## 3.3 Role of the valuer in implementing the Basel 3.1 criteria

The implementation of Basel 3.1 criteria in some jurisdictions creates major issues for the valuation profession. The following points summarise the current position.

- The Basel 3.1 criteria provide an amended framework for the valuation of real estate for lending purposes and apply to both loan origination and any risk weighting for capital adequacy purposes.
- The valuation criteria within Basel 3.1 do not accord with either the definition of market value or the definition of mortgage lending value.
- Basel 3.1 does not give any further guidance on how to interpret or implement the prudently conservative valuation criteria.
- Basel 3.1 places responsibility for the implementation of the criteria on national supervisors. As far as RICS is aware, no national supervisor has addressed the criteria other than in the UK, which has decided specifically to remove one of them from their capital requirements regulations. The EU has included all of the criteria in its revised Capital Requirements Regulation without any guidance on how they are to be implemented.
- The real estate industry in Europe has addressed the criteria, and the real estate industry in other jurisdictions has begun that process.

- There are both theoretically sound and practical solutions to the implementation of the prudently conservative valuation criteria that have been thoroughly tested against past cyclical downturns in real estate markets.
- The solutions are based on an adjustment to the existing basis of market value.
- The solutions require the analysis of real estate markets, and the adjustment factors are not grounded in individual property characteristics.
- The adjustment factor should be based on a long-term trend compared to the current level of market prices.
- The market value with an adjustment factor is not a forecast of the future, it is an assessment of where current prices are relative to past data. It cannot predict any event, especially a non-economic event such as a pandemic.
- The implementation is not straightforward and requires data over the long term.
- Globally there is a significant range in the availability, quality and time frame of that data, and implementation needs to fully take into account the different possibilities for different countries and limitations of the outcomes.
- These solutions could also be applied to long-term sustainable aspects in MLV, such as sustainable rents and capitalisation rates, where these aspects are not prescribed in legislation.

As very few national supervisors have engaged closely with their real estate lending and valuation institutions on prudently conservative valuation criteria, the role of the valuer could become very important. Although national supervisors have the responsibility for providing guidance under the Basel 3.1 criteria, they may pass this responsibility on to lenders who may pass it down to the valuers.

Where supervisors and/or lenders take no responsibility for the adjustment, valuers may be instructed to provide the property valuation under the Basel 3.1 criteria with no guidance.

RICS members and other stakeholders should be aware of the inconsistencies between the Basel 3.1 criteria and the existing bases of market value and mortgage lending value and the current lack of guidance as to its application. RICS members should be wary of accepting instructions that require an assessment of whether an adjustment is required and the quantum of that adjustment.

Where individual valuers do not feel they have the capability or the support to determine the adjustment factor, they have three options:

- decline the whole instruction, or
- **provide a market valuation only. This is the recommended response from RICS. Valuers should explicitly state in the instruction and reporting process that they are not taking into account the prudently conservative valuation criteria and are only providing a market valuation under the IVS definition of market value**, or

- identify the market valuation and the prudently conservative valuation criteria adjustment factor, with the adjustment being provided by the lender in writing.

The procedure for valuers who feel they have the research and analytical framework to provide an adjustment to the market value for the Basel 3.1 criteria would be to:

- contact their regulator/valuer professional organisation to directly understand their interpretation of 'property value' and any preferred approach for making the adjustment within their jurisdiction
- ensure that a reasonable amount of data exists to make the adjustment
- follow the local regulator's/valuer professional organisation's suggested approach where it exists, and
- **declare that the assessment is not a forecast and does not guarantee that the value will not fall below the prudently conservative property value at any point during the life of the loan**.

Members are reminded of their responsibilities under the RICS Rules of Conduct, and it is recommended that contact is made with insurers to ensure professional indemnity insurance covers providing a property value using the Basel 3.1 criteria, and also that the level of liability offered is reasonable.

As there is no clear agreed approach to the estimation of adjustments to market value for the cyclical issues raised by the prudently conservative valuation criteria, Appendix B sets out a summary of the possible alternatives. This includes some long-term modelling developed by the Association of German Pfandbrief Banks (Verband Deutscher Pfandbriefbanken), which follows the principles set out in section 3, as well as the outcome of the various long-term value research projects. It also addresses the monitoring of real estate loan portfolios within the EU CRR III, which includes revaluation requirements.

Given the issues surrounding the Basel 3.1 criteria, global, regional and national valuer associations should be giving support and guidance to individual valuers on the determination of adjustment factors. This practice information has identified principles that can underpin that support.

# Appendix A: Key transparency index metrics and country rankings

| Transparency Level | 2024 Composite Rank | Market | 2024 Composite Score |
|---|---|---|---|
| High | 1 | United Kingdom | 1.24 |
| | 2 | France | 1.26 |
| | 3 | United States | 1.34 |
| | 4 | Australia | 1.37 |
| | 5 | Canada | 1.49 |
| | 6 | Netherlands | 1.49 |
| | 7 | New Zealand | 1.59 |
| | 8 | Ireland | 1.72 |
| | 9 | Sweden | 1.77 |
| | 10 | Germany | 1.79 |
| | 11 | Japan | 1.83 |
| | 12 | Belgium | 1.84 |
| | 13 | Singapore | 1.92 |
| Transparent | 14 | Finland | 1.97 |
| | 15 | Hong Kong SAR | 1.97 |
| | 16 | Denmark | 2.04 |
| | 17 | Switzerland | 2.05 |
| | 18 | Spain | 2.06 |
| | 19 | Italy | 2.12 |
| | 20 | Poland | 2.13 |
| | 21 | Norway | 2.24 |
| | 22 | Czech Republic | 2.27 |
| | 23 | Luxembourg | 2.29 |
| | 24 | Hungary | 2.30 |
| | 25 | Portugal | 2.30 |
| | 26 | Chinese Taipei | 2.34 |
| | 27 | South Korea | 2.35 |
| | 28 | UAE - Dubai | 2.38 |
| | 29 | South Africa | 2.40 |
| | 30 | China - Tier 1 | 2.42 |
| | 31 | India - Tier 1 | 2.44 |
| | 32 | Thailand | 2.53 |
| | 33 | Malaysia | 2.57 |
| | 34 | Romania | 2.61 |
| | 35 | Slovakia | 2.62 |
| Semi | 36 | Greece | 2.71 |
| | 37 | Mexico | 2.77 |
| | 38 | Saudi Arabia | 2.79 |
| | 39 | Israel | 2.79 |
| | 40 | Indonesia | 2.81 |
| | 41 | UAE - Abu Dhabi | 2.87 |
| | 42 | Brazil | 2.89 |
| | 43 | Bulgaria | 2.91 |
| | 44 | Croatia | 2.92 |
| | 45 | Philippines | 2.95 |
| | 46 | Turkey | 2.96 |
| | 47 | Chile | 3.06 |
| | 48 | Peru | 3.14 |
| | 49 | Vietnam | 3.25 |
| | 50 | Slovenia | 3.25 |
| Semi | 51 | Kenya | 3.31 |
| | 52 | Argentina | 3.36 |
| | 53 | Serbia | 3.37 |
| | 54 | Macao SAR | 3.42 |
| | 55 | Colombia | 3.46 |
| | 56 | Mauritius | 3.47 |
| | 57 | Puerto Rico | 3.47 |
| Low | 58 | Malta | 3.54 |
| | 59 | Morocco | 3.55 |
| | 60 | Botswana | 3.62 |
| | 61 | Egypt | 3.64 |
| | 62 | Zambia | 3.68 |
| | 63 | Sri Lanka | 3.69 |
| | 64 | Nigeria | 3.69 |
| | 65 | Bahrain | 3.79 |
| | 66 | Pakistan | 3.87 |
| | 67 | Costa Rica | 3.87 |
| | 68 | Qatar | 3.89 |
| | 69 | Uruguay | 4.00 |
| | 70 | Jordan | 4.02 |
| | 71 | Oman | 4.14 |
| | 72 | Rwanda | 4.14 |
| | 73 | Ghana | 4.15 |
| Opaque | 74 | Ecuador | 4.19 |
| | 75 | Algeria | 4.37 |
| | 76 | Tunisia | 4.38 |
| | 77 | Angola | 4.40 |
| | 78 | Panama | 4.40 |
| | 79 | Uganda | 4.40 |
| | 80 | Mozambique | 4.40 |
| | 81 | Ivory Coast | 4.42 |
| | 82 | Lebanon | 4.43 |
| | 83 | Tanzania | 4.44 |
| | 84 | Senegal | 4.47 |
| | 85 | Honduras | 4.46 |
| | 86 | Dominican Republic | 4.48 |
| | 87 | Guatemala | 4.54 |
| | 88 | Ethiopia | 4.57 |
| | 89 | Iraq | 4.60 |

Source: JLL, LaSalle, 2024

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# Appendix B: Methods of adjusting market value for Basel 3.1 prudently conservative valuation criteria

## B1 Introduction

**The potential methods for adjusting market values for the Basel 3.1 criteria are not agreed, and the following is therefore guidance to valuers who may be instructed to undertake property valuations using the criteria by lenders.**

At the time of writing there are no guidelines from any of the national regulators. If such guidelines are developed in the future, they become the authoritative requirement under Red Book Global Standards.

If valuers are instructed to produce a valuation under the Basel 3.1 criteria, a market valuation will be required against which to benchmark it. In some circumstances, the market valuation can be the outcome of a property valuation using prudently conservative valuation criteria. However, there are circumstances where market factors suggest that an adjustment to the market valuation is required.

The main issue identified in this practice information is the cyclical state of the market and not individual asset characteristics, which should have been identified during the market valuation process. Any adjustments should be related to wider property market characteristics and applied at a market level.

These adjustments may be provided by national regulators, national lender associations, and/or individual lenders. In the absence of any such advice, national valuer associations may provide assistance to their members undertaking this market analysis function.

In the absence of any of the guidance listed above, section B2 provides guidance on potential approaches to identifying when an adjustment should be made and the quantum of that adjustment.

For valuers instructed to undertake a property valuation under the Basel 3.1 criteria who do not feel able to identify when the adjustment may be required and/or the extent of the adjustment, there are alternatives set out in section 3.3.

## B2 Alternative methods of determining market value adjustment factors

The development of long-term valuation models is grounded in the seminal equilibrium rent modelling work of Hendershott and extensive work on the modelling of capitalisation rates by a number of researchers who have investigated the impact of discount rates, expected inflation and risk premia (see Crosby, N. and Hordijk, A., The implementation of long-term valuation models across the UK and Mainland Europe for financial regulation purposes *Journal of Property Research*, vol. 42, p. 142, 2024 for a review).

Section 3 identified that these models have been tested to determine whether they provide the framework to address the Basel 3.1 criteria and provide market level adjustment factors to apply to individual market valuations.

These tests found that the best models were the most sophisticated models but that some very basic trend models also provided robust indicators of cyclical movements and would have been sufficient to satisfy the requirements and objectives of the Basel 3.1 criteria. The research also found that disaggregated models across different segments of a market were preferable but that movements in the prices of different segments of a national property market were highly correlated, and therefore a single property market adjustment factor could provide a robust adjustment factor where data is limited.

Based on those findings, sections B2.1 and B2.2 provide modelling possibilities appropriate for different markets. Appendix A identifies the property market transparency ratings across different countries globally, and one of the major factors in those ratings is the quality and availability of property market data. The attainable level of sophistication in the modelling is dependent on the quality and availability of data and the level of objectivity required in the approach.

### B2.1 Modelling adjustment factors in mature markets

Mature markets are characterised by long-run datasets for economic, financial and property markets. This enables long-term trends to be identified, and an equilibrium model can be generated by studying the relationships between these datasets, identifying at any date of valuation the long-term or equilibrium property value. This can be compared to the market valuation to determine whether an adjustment factor is warranted.

Research into mature markets has used the country ranked number one in the transparency index, the UK, which has the longest-running set of continuous commercial property market data in the world. The research found that a model using forecasting of rental growth was not good enough to identify cyclical upturns or downturns and tested the various long-term equilibrium models against the last two downturns in the UK market, commencing in 1990 and 2007. This found that different long-term equilibrium models successfully identified over-pricing in the two years before the peak across the three main UK commercial real estate segments. This was also the case for a simple past trend model. However, the researchers found that an econometric model using a 15-year rolling set of inputs performed marginally

better than any others, as it was able to take some account of any structural change in markets (for example the changes to retailing and logistics markets in the recent past).

Table B1 sets out economic data used in the 15-year equilibrium rent model that produced the best outcome in predicting the downturns in the rental growth index for the UK. Economic and financial data is available from public sources such as Eurostat, OECD and World Bank as well as from individual countries' national statistics collections. For example, the OECD has detailed data on 55 countries, of which 26 are within the European zone. It has developed data on regions and cities within individual countries, and economic and financial statistics are available for certain indicators. For example, for cities across 21 countries in Europe there is OECD data on demographics, real GDP growth, a range of employment and unemployment data and household disposable income. World Bank has basic GDP data for 216 states.

| Market segment | Demand variables | Supply variables |
|---|---|---|
| Office segment | Real GDP | Floorspace, interpolated using real construction orders |
| Retail segment | Real household consumption | Floorspace, interpolated using real construction orders |
| Industrial/logistics segment | Real GDP | Floorspace, interpolated using real construction orders |

Table B1: Economic variables used in the Investment Property Forum Research Programme long-term value research IPF long-term value methodologies in commercial real estate lending, 2020

In addition to the economic and financial data, the modelling requires real estate market data. Many of the major mature property markets have long-run real estate market datasets enabling them to produce equilibrium rent models that, coupled with basic capitalisation rate modelling, create a long-run capital value series to compare with actual capital values/prices. The datasets required for capitalisation rate models are past capitalisation rates, real interest rates, inflation, risk premia and rental growth rates.

A simple capital value trend model also predicted both major downturns, even though the accuracy of the simple trend model was lower than where the elements of structural change in markets were included. In addition, while the development of more sophisticated models requires some subjectivity in their construction, such as which elements to include, the calculation of a past trend requires just two subjective choices: the time frame of the past data and the dataset to use. The latter is a subjective choice in all long-term modelling using market data.

Most recently, the German Association of Pfandbrief Banks Research Section (vdpR) has developed its own version of a long-term trend model. The model aligns with this RICS

practice information and is based on an individual property market valuation and a market level adjustment factor to represent the Basel 3.1 criteria.

This adjustment is based on statistical approaches across national regions and property types, using relevant market data to determine whether current cyclical property prices/ market values are above or below long-term trends. The approach uses a particular statistical approach (the Hodrick–Prescott (HP) filter) to determine a long-term trend and compares this trend with the actual prices to identify the adjustment factor if prices are above the long-term trend. Although the model is based on a simple trend, the use of the HP filter gives a greater degree of sophistication and allows for more weight to be assigned to recent data.

MSCI and other index providers and real estate consultants hold detailed real estate demand, supply and price data, but it is private and not publicly available.

## B2.2 Modelling adjustment factors in immature markets

The same availability is not true for less mature markets, so the main difference between mature and immature markets in the context of long-term valuation is the data availability. Research into the less mature markets within Europe indicated that there were many markets where little or no past property market data exists, either in the public domain or in private subscription datasets. The exception was rental growth and capitalisation rate data for (mainly) capital cities held in the datasets of major real estate services companies in those countries. This data could be used to produce basic rent and yield indices. The range of market maturities across Europe mimics the range of market maturities globally.

Basic trend modelling requires the nominal capital values to be discounted by the inflation rate to produce real indices of capital value change. A line of best fit is then calculated through this data before adding back the inflation series to both indices and comparing the difference to see whether any adjustment is indicated. The UK research into long-term value found simple trend models to be less efficient than more sophisticated approaches.

## B2.3 Long-term data on property markets

At the lowest level of sophistication, a long-term trend model requires basic property price data over an extended period of time. The UK research used a rolling 15-year period to test the efficiency of the models. A longer time period is desirable to assess longer-term cyclical movements.

Indices of prices, rents and yields are available for many countries globally, but many of these indices are in private hands and subscription based, and there are restrictions on what they can be used for. Additionally, there may be financial regulations that require any indices or benchmarks to be authorised by national supervisors.

Where those data sources exist, the research has illustrated that determining adjustment factors centrally is a feasible solution to the implementation of the Basel 3.1 criteria and

would provide valuable supporting information for the determination of sustainable rents in MLV calculations.

Countries where long-term real estate data exists in index form include Australia, Austria, Belgium, Brazil, Canada, Czechia, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, South Africa, South Korea, Spain, Sweden, Switzerland, the UK, the US and, to a lesser extent, Bulgaria, Romania, Slovakia, China, Hong Kong, Indonesia, Malaysia, Singapore, Taiwan and Thailand (Crosby, N. and Hordijk, A., The implementation of long-term valuation models across the UK and Mainland Europe for financial regulation purposes *Journal of Property Research*, vol. 42, p. 142, 2024).

Additionally, research across Europe within countries with less mature property markets showed that data in the form of rents and capitalisation rates was held in the files of the major property consultants, and the range of maturity of markets across Europe mirrors the range globally.

Where national associations take on responsibility for providing support on market value adjustments, the first priority is to assess access to the data necessary to develop long-term value trend models.

# Appendix C: Implementation status of Basel 3.1 revised standardised approach for credit risk by country, Q3 2024

| Country | Implementation position Q3 2024 |
|---|---|
| Argentina | Final rule published (not yet implemented by banks) |
| Australia | Final rule in force (published and implemented by banks) |
| Brazil | Final rule in force (published and implemented by banks) |
| Canada | Final rule in force (published and implemented by banks) |
| China | Final rule in force (published and implemented by banks) |
| Hong Kong | Final rule published (not yet implemented by banks) |
| India | Draft regulation not published |
| Indonesia | Final rule in force (published and implemented by banks) |
| Japan | Final rule in force (published and implemented by banks) |
| Mexico | Final rule in force (published and implemented by banks) |
| Russia | Draft regulation published |
| Saudi Arabia | Final rule in force (published and implemented by banks) |
| Singapore | Final rule in force (published and implemented by banks) |
| South Africa | Draft regulation published |
| South Korea | Final rule in force (published and implemented by banks) |
| Switzerland | Final rule published (not yet implemented by banks) |
| Turkey | Draft regulation not published |
| UK | Final rule published (not yet implemented by banks) |

| Country | Implementation position Q3 2024 |
|---|---|
| US | Draft regulation published |
| European Union | Final rule published (not yet implemented by banks) |

Source: Bank for International Settlements implementation dashboard (RCAP on timeliness: Basel III implementation dashboard)

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