Commission de Surveillance du Secteur Financier

# Circular CSSF 22/803

## Introduction of a semi-annual data collection on lending indicators related to commercial real estate

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**Re**: Introduction of a semi-annual data collection on lending indicators related to commercial real estate

Luxembourg, 18 March 2022

**To all credit institutions and to all branches of EU and non-EU credit institutions, granting commercial real estate loans (hereinafter "lenders")**

Ladies and Gentlemen,

Following-up on the Recommendation of the European Systemic Risk Board of 21 March 2019 amending Recommendation ESRB/2016/14 on closing real estate data gaps (ESRB/2019/3), the CSSF, as the national designated authority, aims at introducing a semi-annual data collection on lending indicators related to commercial real estate in Luxembourg.

The collection of data and indicators will help identifying the build-up of systemic risks and assessing the potential need for macroprudential intervention. Granular and consistent data are necessary to capture market developments and to analyse systemic risks adequately.

The circular introduces the definitions of these indicators, which are collected via a dedicated template available on the CSSF website.

**Key information**

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| **Addressee** | To all credit institutions and to all branches of EU and non-EU credit institutions, granting commercial real estate loans |
| **Scope** | Loans aimed at acquiring a CRE property or secured by a CRE property |
| **Reporting threshold** | EUR 250 million, based on FINREP at the lowest solo level, Table 18, row 0140, column 010; to be computed in the month of December of the year preceding the submission date |
| **Frequency** | Semi-annual |
| **Submission date** | 15 April and 15 October of each year |
| **Template** | Available on CSSF website |
| **Contact** | macropru@cssf.lu |

# 1. Scope and definitions

Lenders are required to report the information requested in the template. The template is composed of six sheets:

1. A cover page, which asks for general information about the reporting institution;
2. A sheet describing the scope, to guide reporting institutions filling in the template;
3. A sheet on data related to the stock of existing CRE loans, non-performing loans (NPLs) and loan loss provisions (LLPs);
4. A sheet on data related to lending indicators on the stock of existing CRE loans;
5. A sheet on data related to the new production of CRE loans, NPLs and LLPs;
6. A sheet on data related to lending indicators on the new production of CRE loans;

Lenders are required to report the information at the lowest solo level of consolidation (i.e. reporting on an individual level, excluding the foreign branches).

## 1.1 CRE loans, non-performing loans and loan loss provisions

CRE loans are defined as loans aimed at acquiring a CRE property (or set of CRE properties) or secured by a CRE property (or set of CRE properties). This definition is composed of two scopes, referred to as "scope 1" and "scope 2":

- **Scope 1: loans with a CRE purpose**

  Scope 1 includes loans extended to a legal entity aimed at:

  (i) acquiring income-producing real estate (or a set of properties defined as income-producing real estate), either existing or under development, or

  (ii) acquiring real estate used by the owners of the property for conducting their business, purpose or activity (or a set of such properties), either existing or under construction.

- **Scope 2: loans with a CRE collateral**

  Scope 2 includes loans extended to a legal entity secured by a commercial real estate property (or set of commercial real estate properties).

In this framework, lenders are asked to report the requested information in the various sheets according to these two scopes.

For stock data, lenders should provide information on existing CRE loans, NPLs and LLPs, as at the end of the reporting period, while flow data are defined as all new production of loans, NPLs or LLPs, over the 6-month reporting period for the entire existing CRE portfolio.

Commission de Surveillance du Secteur Financier

Loans should be measured by the granted amount of each loan or tranche. The granted amount is the loan amount offered by the lender to the borrower as per contractual provisions and signed by the stakeholders concerned. Borrowers may have received one or more loan offers from different lenders but a contract becomes binding only upon signature by the borrower. The amount referred to in the signed contract should be reported by the lender as the granted loan amount.

Renegotiated loans should be included in the new production if the lender considers them as new loans. However, in the particular case where the lender took over an existing loan from another lender, the repurchased loan must be considered as a new loan.

In line with the FINREP definition, non-performing loans are defined as any credit exposure that satisfies either or both of the following criteria: (a) material exposure that are more than 90 days past-due; (b) 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.

Loan loss provisions refer to the total amount of provisions made on loan portfolios to account for potential future credit losses. The provisions refer to all stages of the IFRS 9 framework.

The acquired CRE property or the CRE property used as a collateral can be located either in Luxembourg or abroad.

## 1.2 CRE purpose

In the context of scope 1, the template asks lenders to classify their CRE lending by purpose. These different purposes are:

- loans for acquiring property held by owners for the purpose of conducting their business, purpose or activity, either existing or under construction;
- loans for acquiring existing rental housing;
- loans for acquiring existing income-producing real estate (other than rental housing);
- loans for acquiring CRE property under development; and
- loans for acquiring existing property held specifically for social housing.

Rental housing is defined as any real estate which is owned by legal entities primarily for letting to tenants[1].

[1] *For cases where the loan for letting purposes is asked by a natural person, the loan should be reported in the template referred to in the Circular CSSF 21/772.*

Income-producing real estate means all immovable properties with income generated by their rents or profits from their sale.

Property under development encompasses all property under construction and intended to provide, upon completion, an income to its owner in the form of rents or profits from its sale. It does not include buildings being demolished or sites being cleared for possible development in the future.

A property is considered as social housing when its transaction value or the rent applied to tenants in such a property is directly influenced by a public body, which results in rents being lower than those observed in the current market. For the purpose of this data collection, loans granted for acquiring property held for social housing refer to exposures towards one or several of the following entities:

- Fonds du Logement;
- Société Nationale des Habitations à Bon Marché ;
- Agence immobilière sociale - Fondation pour l'accès au logement ;
- Communes and syndicats de commune ; and
- Non-profit organisations, foundations, funds for the management of religious buildings, religious communities having concluded an agreement with the government, civil hospices or social offices wishing to set up a subsidized housing project for rental purpose;

with the additional condition that the purpose of the loan excludes conducting their own business, purpose or activity.

As a general principle, when the property has several purposes, the loan must be subdivided according to the different property purposes (based for example on the surface areas dedicated to each use) whenever it is feasible to make such a breakdown; otherwise, the loan can be classified according to the dominant purpose of the property.

## 1.3 CRE property type

Lenders are required to categorize their loans by property type. Property type refers to the primary use of the CRE property, which is the CRE acquired in the context of scope 1, or the CRE used as a collateral in the context of scope 2. This breakdown covers the following categories:

a) residential, e.g. multi-household premises;

b) retail, e.g. hotels, restaurants, shopping malls;

c) office, e.g. a property primarily used as professional or business office;

d) industrial, e.g. property used for the purposes of production, distribution and logistics;

e) other types of commercial property.

As a general principle,

- under scope 1, when the property is of a mixed type, the loan must be subdivided according to the different property types (based for example on the surface areas dedicated to each use) whenever it is feasible to make such breakdown; otherwise, the loan can be classified according to the dominant type of the property.
- under scope 2, when the collateral is of a mixed type or consists of several properties with different types, the collateralized loans should be subdivided into the different property types of the collateral (based for example on the surface areas dedicated to each use) whenever it is feasible to make such a breakdown; when such a subdivision is not feasible, the collateralized loans can be classified according to the dominant type of the collateral.

### 1.4 CRE property location

Lenders should classify loans based on the location of the property. This property refers to the acquired property in the case of scope 1 and to the property used as a collateral in the case of scope 2. Three categories of location are considered:

- Domestic prime;
- Domestic non-prime; and
- Foreign.

A prime location is generally considered the best location in a particular market, which is also reflected in the rental yield (typically the lowest in the market). For office buildings, a prime location could be a central location in a major city (which includes, but is not limited to, the Central Business District (CBD) or Kirchberg in the case of Luxembourg). For retail buildings, a prime location may refer to a city centre with many pedestrians or a shopping mall. For logistics buildings, a prime location may refer to a location where the necessary infrastructure and services are in place, and which offers excellent access to transport networks (such as e.g. the Findel in the case of Luxembourg).

### 1.5 Type of loans

Loans should be classified according to their amortization method. The two loans categories are:

- Amortizing loans;
- Non-amortizing loans.

Commission de Surveillance du Secteur Financier

Amortizing loans are defined as loans that have contractual regular amortizing repayments over the lifetime of the loan that would result in total repayment by the date of maturity. Regular payments include an interest charge and a capital charge, while non-amortizing loans are any loans that do not fall into the category of amortizing loans, such as interest only loans or bullet loans, for instance.

## 1.6 Loan-to-value (LTV)

### 1.6.1 Loan-to-value ratio at origination (LTV-O)

The loan-to-value ratio at origination (LTV-O) means the sum of all loans or loan tranches secured by the borrower on the [collateralized] property at the moment of loan origination relative to the value of the [collateralized] property at the moment of loan origination. Given this definition, LTV is consistent with scope 2[1] and is computed at the transaction level[2].

$$\mathbf{LTV - O = \frac{L}{V\ at\ origination}}$$

For the purpose of the calculation, “L”:

- Should include all loans or loan tranches secured by the borrower on the immovable property at the moment of origination irrespective of the purpose of the loan.
- Should be measured by the granted amount of each loan or tranche. The granted amount is the loan amount offered by the lender to the borrower as per contractual provisions and signed by the stakeholders concerned. Borrowers may have received one or more loan offers from different lenders but a contract becomes binding only upon signature by the borrower. The amount referred to in the signed contract should be reported by the lender as the granted loan amount.
- Should not be adjusted for the presence of other credit risk mitigants.
- Should not include costs and fees related to the loan.
- In case of several purposes, should be classified according to the dominant purpose of the property.
- Should not include loan subsidies.

*[1] It should be noted however that in case where LTV is calculated for different CRE purposes (scope 1), the definition refers to the loans with a CRE purpose and a CRE collateral (the intersection of scopes 1 and 2).*

*[2] Transaction level means that LTV should be computed regardless of the number of collaterals used to cover the loan as opposed to the computation of an LTV at the collateral level. Hence, it is not expected to report an LTV ratio for each collateral used, but one per transaction.*

In case of a renovation loan being granted in addition to a loan for acquiring a commercial real estate property, only one LTV should be computed, with the L including both loan amounts.

For the purpose of the calculation, "V at origination":

- Should be computed on the basis of the value of the property (or set of properties) given as collateral.
- Should be computed on the basis of the property's (or set of properties) value(s) at origination, measured as the lower of:
    - the transaction value, e.g. as registered in a notarial deed, and
    - the value as assessed by an independent external or internal appraiser.

  If only one value is available, this value should be used. It is not possible to use the mortgage value registered in a mortgage collateral register ("inscription hypothécaire") nor the mortgage promise value ("mandat hypothécaire") to obtain the value.

- Should be adjusted by the total amount of the outstanding loan, disbursed or not, that is secured through 'prior' liens on the property. In cases where one or several higher ranked mortgages exist on the property given as collateral, V is lowered by the mortgage value or the outstanding amount of a loan secured in first lien by this same property.
- Should not be computed as the 'long-term value' because the value at origination aims at capturing credit standards at origination.
- Should not be adjusted for the presence of other credit risk mitigants.
- Should not include costs and fees related to the CRE loan.

In the case of a loan for the renovation of a CRE property that is also used as the collateral of the transaction, the V at origination should be augmented by a fraction of the renovation costs with a range of 0% to 80% of their value as stated in the offer documents ("devis"). The lender should define internal policies to guide decisions on the fraction of renovation costs that will augment the value and follow them systematically.

In the case of a loan for the acquisition of land ("terrain") for the purpose of building a CRE property, land that is also used as the collateral of the transaction, the value of the land is augmented by an estimation of the construction costs based on the offer document/construction contract from the constructor. If, for any reason, the buyer/borrower cannot provide evidence on the estimation of future construction costs, the property value should be the price of the land. In the case of the acquisition of a CRE property under development, the property value is the selling price of the project as agreed in the notarial deed.

Commission de Surveillance du Secteur Financier

#### 1.6.2 Current loan-to-value ratio (LTV-C)

The current loan-to-value ratio (LTV-C) means the sum of all loans or loan tranches secured by the borrower on a [collateralized] property at the submission date relative to the current value of the [collateralized] property.

$$\mathbf{LTV - C = \frac{LC}{V\ current}}$$

For the purpose of the calculation, “LC”,

- Is measured as the outstanding amount of the loan(s) at the reporting date, taking into account capital reimbursements, loan restructurings, new capital disbursements, incurred interest, and, in the case of loans in foreign currencies, changes in the exchange rate.
- Should follow the same principles as described for LTV-O, when applicable.

For the purpose of the calculation, “V current”,

- Should be monitored and reviewed in accordance with Article 208(3) CRR. Therefore, it should be assessed by an independent external or internal appraiser.

  As specified in Article 208(3) CRR, collateral valuations should take place at least once a year for commercial immovable property, while more frequent valuations are carried out if the market has been subject to significant negative changes and/or if there have been signs of a significant decline in the value of the individual collateral.
- Should follow the same principles as described for LTV-O, when applicable.

## 1.7 Interest coverage ratio (ICR)

The interest coverage ratio (ICR) means the gross annual rental income (i.e. before operational expenses and taxes) accruing from a CRE property or set of properties relative to the annual interest cost of the loan; the ratio can refer to its value at loan origination or its current value.

$$\mathbf{ICR = \frac{gross\ annual\ rental\ income}{Annual\ interest\ costs}}$$

For the purposes of calculating ICR:

- The “gross annual rental income” includes the annual rental income accruing from renting property to tenants, before taxes and any operational expenses to maintain the property's value and – in the case of cashflow – adjusted for other costs and benefits directly connected with the use of the property.
- The “annual interest costs” are annual interest costs associated with the loan.

The ICR's purpose is to measure the extent to which the income generated by a property is sufficient to pay for the interest expenses incurred by a borrower to purchase that property. Given this definition, ICR is consistent with scope 1 and should therefore be calculated at the property level.

### 1.8 Debt service coverage ratio (DSCR)

The debt service coverage ratio (DSCR) means the gross annual rental income generated by a CRE property that is at least partially financed by debt, before taxes and any operational expenses to maintain the property's value, relative to the annual debt service on the loan; the ratio can refer to its value at loan origination or its current value.

$$\mathbf{DSCR} = \frac{\textbf{gross annual rental income}}{\textbf{Annual debt service}}$$

For the purpose of calculating DSCR:

- The "gross annual rental income" includes the annual rental income accruing from renting property to tenants, before taxes and any operational expenses to maintain the property's value and – in the case of cashflow – adjusted for other costs and benefits directly connected with the use of the property.
- The "annual debt service" is the annual debt service associated with the loan.

The DSCR's purpose is to assess the weight of the overall debt burden that a property generates for a borrower. Hence, the denominator includes not only interest expenses, but also loan amortisation, i.e. principal repayments. Given this definition, DSCR is consistent with scope 1 and should therefore be calculated at the property level.

## 2. Reporting process

This section describes the procedure for the submission of the template.

### 2.1 Accessing the template

The template can be found on the CSSF website under "credit institution – prudential reporting for credit institution – Ad hoc reports (see link)"

## 2.2 Reporting threshold

Blank reports should be submitted in year Y if the amount reported in FINREP Table 18, row 0140, column 010 (*gross carrying amount for loans and advances to non-financial corporations, of which: Loans collateralised by commercial immovable property*), did not exceed EUR 250 million at the 31 December of year Y-1.

## 2.3 Frequency

The data should be submitted semi-annually to the CSSF, in April and October of each year.

On the **15 April of a given year**, the template should include:

- All the new exposures that were issued between 1 July and 31 December of the previous year;
- All outstanding exposures up until 31 December of the previous year.

On the **15 October of a given year**, the template should include:

- All the new exposures between 1 January and 30 June of the same year;
- All outstanding exposures up until 30 June of the same year.

## 2.4 Standards for transmission

The filled-in template must be submitted to the CSSF at the defined submission date through one of the currently accepted transmission channels E-file or SOFiE. The template should be named as follows:

**ESPREP-ENNNN-YYYY-MM-CRE**

Where

- ESP is the reporting type standing for special enquiries
- REP is the direction standing for Report
- E is the entity type, e.g. B for Banks
- NNNN is the identification number of the bank, i.e. 0001...9999
- YYYY is the cut-off year of the data (reporting reference period)
- MM is the cut-off month of the data (reporting reference period)
- CRE is the table reference.

For further specification on the CSSF's naming conventions, please refer to information published on the CSSF website.

Commission de Surveillance du Secteur Financier

## 3. Contact

For any questions regarding this circular, please contact the macroprudential division of the CSSF (email: macropru@cssf.lu).

This circular is applicable as of its publication date.

Yours faithfully,

| | | |
|---|---|---|
| **Claude WAMPACH**<br>Director | **Marco ZWICK**<br>Director | **Jean-Pierre FABER**<br>Director |
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