High Volatility Commercial Real Estate (HVCRE) Rule

MBA-led legislation addressed problematic HVCRE rule affecting bank ADC lending

BACKGROUND

In July 2013, U.S. banking regulators issued the Basel III Regulatory Capital and Market Risk Rules. That issuance included a High Volatility Commercial Real Estate (HVCRE) rule, under which certain acquisition, development and construction (ADC) loans are subject to a 150 percent risk weight. The rule became effective on January 1, 2015.

Banks found that the HVCRE rule was not sufficiently clear and that it did not accurately reflect the nature of prudent ADC lending. As a result, many banks overclassified ADC loans as HVCRE (holding higher capital for ADC loans that lacked the higher risk the HVCRE rule was intended to capture) and reduced their ADC lending. Banks’ ability to compete for sound, prudently underwritten ADC loans was impaired.

ADVOCACY

MBA was able to successfully advocate for legislation to address the weaknesses in the HVCRE rule. Effective May 24, 2018, a provision of the Economic Growth, Regulatory Relief, and Consumer Protection Act clarified the application of the rule and better aligned HVCRE capital treatment with factors affecting credit risk, as follows:

• Clarify the definition of an “HVCRE ADC Loan” (i.e., secured real property ADC loans where repayment is dependent upon future income/sale proceeds of such property);
• Clarify that loans to acquire or improve existing, performing, income-producing properties that meet financial institution’s applicable loan underwriting criteria for permanent financing are not HVCRE ADC loans;
• Permit banks to count the value of appreciated property toward borrower’s required 15 percent capital contribution;
• Remove mandatory restrictions on removing internally generated capital for life the loan;
• Permit banks to allow borrowers to remove contributed capital from a project when a bank determines that project meets financial institution’s applicable loan underwriting criteria for permanent financing;
• Authorize banks to withdraw HVCRE status prior to the end of an ADC loan when a bank determines that a project meets underwriting requirements for permanent financing; and
• Exempt loans originated prior to January 1, 2015.

For more information, visit mba.org or call (202) 557-2700.
IMPLEMENTATION

The new law superseded contrary provisions of the banking agencies’ risk-based regulations, effective immediately on May 24, 2018. MBA urged the federal banking agencies to provide interim guidance to apply until the agencies can complete a rulemaking to update their regulations. On July 6, 2018, the federal banking agencies responded, issuing interim guidance to banks. That guidance provided banks with the flexibility to report HVCRE exposures under the existing rules or under the new law, pending a rulemaking by the banking agencies to amend the HVCRE rule.

On September 28, 2018, the federal banking agencies published proposed amendments to their risk-based capital regulations to conform them to the HVCRE provisions in S. 2155. On November 11, 2018, MBA submitted comments to the agencies responding to the proposal and requested the withdrawal of the agencies’ 2015 FAQs interpreting the pre-legislation HVCRE rule.

On December 13, 2019, the agencies published a final HVCRE rule. The final rule formalizes implementation of the 2018 legislation and followed MBA’s recommendations on treatment of raw land, on condo construction, on not adding an interpretation of “primarily finances,” on making re-evaluation of loans originated since January 1, 2015, optional, on the use of an “as-completed” value for an entire multi-phase project, and on pulling the old FAQs.

GOING FORWARD

MBA will continue to monitor the actions of the federal banking regulators to help ensure that they implement the regulations implementing the HVCRE legislation in a manner that provides the clarity and relief that Congress intended to provide.

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