High Volatility Commercial Real Estate (HVCRE) Rule

MBA-led legislation addresses 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 the HVCRE rule to be insufficiently 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 were 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.
IMPLEMENTATION

The new law superseded contrary provisions of the banking agencies' risk-based regulations, effective immediately, so MBA urged the federal banking agencies to provide guidance to banks pending the completion of a rulemaking to update their regulations.

July 6, 2018, the federal banking agencies responded, issuing interim guidance to banks, recognizing the change in the law, and providing banks with the flexibility to report HCVRE exposures under the existing rules or under the new law, pending a rulemaking by the banking agencies to amend the HVCRE rule.

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 also requesting the withdrawal of the agencies' 2015 FAQ’s.

RECOMMENDATION

MBA will monitor the actions of the federal banking regulators to help ensure that they implement the HVCRE provision of S. 2155 in a manner that provides the clarity and relief that Congress intended to provide.

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