TREATMENT OF HIGH VOLATILITY COMMERCIAL REAL ESTATE (HVCRE)

The federal banking agencies have finalized a rule implementing the provision of the S. 2155 regulatory reform law regarding the treatment of high volatility commercial real estate. The law limits the exposures subject to a 150 percent risk weight to only those high–volatility commercial real estate loans that fall under the statutory “HVCRE ADC” definition. The final rule becomes effective on April 1, 2020.

The final rule defines an HVCRE ADC loan as one that is primarily financing or refinancing the acquisition, development or construction of a real property; is secured by land or improved real property; has the purpose of providing financing to acquire, develop or improve the real property such that the property would become income producing; and is dependent upon future income or sales proceeds from, or refinancing of, the real property for repayment of the loan. The Statutory HVCRE ADC definition excludes any loan made prior to January 1, 2015.

Under the final rule, loans secured by land or improved real property may be excluded from the higher risk weight if they meet one or more criteria. These include loans that made to finance one–to–four family residential properties; real property projects for which the primary purpose is community development; agricultural land; existing income-producing real property secured by a mortgage on such property, provided certain conditions are met; and certain commercial real property projects.

A credit facility financing a commercial real property projects would have to meet four distinct criteria to qualify for the exclusion from the revised HVCRE exposure definition. First, the loan–to–value ratio would have to be less than or equal to the applicable supervisory maximum. Second, the borrower would have to have contributed capital of at least 15 percent of the real property’s appraised “as completed” value to the project. Third, the 15 percent amount would have to be contributed prior to the institution’s advance of funds, except for nominal sums meant to secure the depository institution’s lien on the real property. Fourth, the 15 percent amount of contributed capital would have to be contractually required to remain in the project until the loan can be reclassified as a non-HVCRE exposure.

“Other land loans,” (generally loans secured by vacant land except land known could be used for agricultural purposes) are typically within the scope of the revised HVCRE exposure definition.

The foregoing Compliance Update is for informational purposes only and does not constitute legal advice. As a reminder, the NBA general counsel is the attorney for the Nebraska Bankers Association, not its member banks. The general counsel is available to assist members with finding resources to help answer their questions. However, for specific legal advice about specific situations, members must consult and retain their own attorney.