LEGISLATIVE UPDATE

115TH CONGRESS REFORMS HVCRE REGULATIONS

By Erin Stackley

The 115th Congress has focused on regulatory reform, particularly bills to narrowly-tailor and focus existing, overly-broad regulations to better address the issues they were meant to resolve. Financial regulations especially have been targets of this. Passed to protect against another financial crisis, many of these regulations dramatically increased compliance burdens, felt most heavily by regional and community lenders, which did not cause the issues these regulations were meant to fix. These types of lenders are frequently the source of financing for NAR Commercial practitioners and their clients.

Against this background is the Basel III "High Volatility Commercial Real Estate Exposures" (HVCRE) risk-weight rule. In January 2015, the Basel Committee on Banking Supervision implemented this new risk-weight category for commercial acquisition, development, and construction (ADC) loans. It raised the risk-weight for those loans from 100 percent to 150 percent, increasing the cost to lenders and generally making commercial real estate loans less attractive as compared to other types with lower risk-weights. Additionally, the rule was vague, and its lack of details on implementation and exceptions led to confusion amongst lenders.

Both Congress and the federal banking agencies introduced proposals to reform the HVCRE regulations. The Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve issued a notice of proposed rulemaking in 2017 to replace the HVCRE rule with a new standard, called the High Volatility Acquisition, Development, and Construction rule. It proposed lowering the risk-weight for those loans to 130 percent, but also removed several exceptions included in the HVCRE rule, thus expanding the type and number of loans included. NAR sent a comment letter to the agencies urging them to consider further lowering the risk-weight to pre-HVCRE levels of 100 percent, and to include the exceptions currently in place to HVCRE.

In Congress, H.R. 2148, the Clarifying Commercial Real Estate Loans Act was introduced in the House by Representatives Pittenger (R-NC) and Scott (D-GA), and companion legislation, S. 2405 was introduced in the Senate by Senators Cotton (R-AR) and Jones (D-AL). NAR strongly supported both bills, and worked as part of a coalition of industry groups to advocate for their passage. Each bill received bipartisan support in its respective chamber, and the House passed H.R. 2148 by voice-vote. Ultimately, the language from these bills was included in the regulatory relief package S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, passed by Congress and signed into law in May 2018.

The "fix" included in S. 2155 clearly defines both "HVCRE ADC" loans and their exemptions. Under it, "HVCRE ADC" loans are: those which primarily finance ADC projects; provide financing for acquiring, developing, or improving real estate into income-producing; and depend on future income, sales, or proceeds from the property to repay the loan. Exemptions are: loans placed into service prior to 2015; ADC loans for 1-4 family residential; real estate investments in community development or agricultural land; acquisition, refinancing, or improving existing income-producing real estate secured by a mortgage on that property if the

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cash flow is enough to support its debt services and expenses; and commercial real estate with a loan-to-value ratio meeting requirements set by the federal banking agencies and contributed capital of at least 15 percent of the property's appraised “as completed” value.

NAR was pleased that this language was included in S. 2155 and ultimately passed into law, as it should relieve some of the undue burden smaller lenders face to make commercial real estate loans, and improve the lending environment for them generally. It is now up to the regulatory agencies to issues rules implementing the language from S. 2155. NAR will continue to monitor this issue and work with the agencies to make sure that it is implemented in a way that accomplishes the intent of the original legislation.