

NAR Issue Summary

Commercial / Basel Capital Standards for Banks and Thrifts

NAR Committee:

Commercial Legislation and Regulatory Advisory Board

What is the fundamental issue?

International, voluntary regulatory capital standards for banks are developed by the Basel Committee on Banking Supervision. The most recent round of updates, referred to as Basel III, has been in an implementation cycle since 2013.

In January 2015, the standard was changed to create a new risk-based capital category – High Volatility Commercial Real Estate Exposures (HVCRE) for commercial acquisition, development, and construction (ADC) loans. These changes raised the risk-weight for an ADC loan from 100 percent to 150 percent. As a result of these changes, commercial loans are less attractive to lenders, and it is highly likely that banks will change their current lending practices and reduce the amount of available commercial real estate credit in order to avoid the higher capital charges associated with ADC loans.

The Federal Banking Agencies (FDIC, OCC, and Federal Reserve) issued a notice of proposed rulemaking in 2017 to replace the Basel III HVCRE rule with a new standard, the High Volatility Acquisition, Development, and Construction rule, which would have a slightly lower risk-weight of 130%, but would not include several of the exceptions to the HVCRE rule, thus expanding the type and number of loans included in it.

I am a real estate professional. What does this mean for my business?

Basel III agreement will require banks to hold more capital. The changes could significantly curtail the flow of capital to real estate and harm the commercial and residential property market and property values. Further, the creation of the HVCRE standards means that loans used for commercial acquisition, development and construction loans will become more complex.

NAR Policy:

While NAR supports the Basel Committee's objective to prevent another financial crisis, NAR is concerned that requiring banks to hold far more capital could further exacerbate credit challenges for real estate and broader credit capacity. Furthermore, NAR seeks to protect and enhance the flow of capital to commercial and residential real estate by making sure that the capital rules do not require excessive capital to be held by banks.

Opposition Arguments:

Proponents of Basel III argue that by requiring banks to hold more capital, they improve their ability to absorb shocks arising from financial and economic stress, and improve their risk management. These proponents also believe that the heightened capital requirements strengthen banks' transparency and their disclosures.

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Legislative/Regulatory Status/Outlook

The final rule went into effect on January 1, 2015. The final rule clarifies that the definition of HVCRE does not apply to the purchase or development of agricultural land if the valuation of the land is limited to the value of the land for agricultural purposes or to ADC loans that otherwise qualify as community development investments. Loans permanently financing owner occupied commercial real estate are not considered HVCRE under the final rule. No other changes were made to the HVCRE definition and HVCRE loans are risk-weighted at 150% under the final rule.

On April 26, 2017, Representatives Robert Pittenger (R-NC) and David Scott (D-GA) introduced H.R. 2148, the "Clarifying Commercial Real Estate Loans Act." This legislation would provide much-needed clarity to lenders about which loans should be categorized as HVCRE ADC, and thus subject to the higher risk-weight, as well as how to apply the exceptions to the rule. NAR worked with a coalition of commercial real estate groups to assist in crafting the legislation, and urged for its passage in the House. The bill was approved by the Financial Services Committee by a vote of 59-1, and on November 7, 2017, it passed the House of Representatives by voice vote. In February 2018, Senators Cotton (R-AR) and Jones (D-AL) introduced companion legislation in the Senate, S. 2405. NAR has thanked the Senators for introducing it and is supporting it in the Senate Banking Committee.

In the Fall 2017 the federal banking agencies (OCC, FDIC, and Federal Reserve) issued a notice of proposed rulemaking on capital risk-weight requirements. The agencies proposed replacing HVCRE with a new standard, "HVADC" (High Volatility Acquisition, Development, and Construction loans), which would have a lower risk-weight of 130%. However, the HVADC standard would also remove several exceptions currently included in the HVCRE rule. NAR sent two comment letters to the agencies - one as sole author, one as part of a commercial real estate coalition - urging them to consider further lowering the risk-weight to pre-HVCRE levels of 100%, and to include the exceptions from the HVCRE rule.

Current Legislation/Regulation (bill number or regulation)

[Basel III Final Rule](#)

[HR 2148 - Clarifying Commercial Real Estate Loans Act](#)

[S2405 - Clarifying Commercial Real Estate Loans Act](#)

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