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. These changes made commercial loans less attractive to lenders, and many banks adjusted their lending practices and reduced the amount of available commercial real estate credit in order to avoid the higher capital charges associated with ADC loans. Additionally, the lack of clarity around the new standard created confusion, resulting in different applications of the requirements by different lenders all trying to stay in compliance.

In response, legislation was introduced in Congress to clarify and amend the HVCRE rules, and the federal banking agencies also proposed regulations to adjust them. In May 2018, Congress passed S. 2155, a regulatory relief package which clarifies definitions and exemptions in the HVCRE rule. The federal banking agencies have since taken up the rulemaking process to propogate final regulations in adherence to the law.

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 managment. These proponents also believe that the heightened capital requirements strenghten banks' transparency and their disclosures.

Legislative/Regulatory Status/Outlook

The new HVCRE standard went into effect in 2015. Among other things, the final rule clarified 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.

In the Fall 2017 the federal banking agencies (OCC, FDIC, and Federal Reserve) 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 to the HVCRE rule, thus broadening the types of loans included in the higher risk-weight. 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.

In 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 on November 7, 2017, it passed the House of Representatives. In February 2018, Senators Cotton (R-AR) and Jones (D-AL) introduced companion legislation in the Senate, S. 2405. NAR supported that bill as well and urged its passage. In May 2018, S.2405 was included in a regulatory relief package bill (S.2155), which passed the Senate and House and was signed into law. The federal banking agencies are finalizing regulations bringing the rules into accordance with the law.

The new law defines which loans are "HVCRE" and under what circumstances a loan can be exempted from that category. These exemptions include one-to-four unit family residential properties, investments in community development or agribultural land, and certain well-capitalized loans. Taken as a whole, it clarifies and modifies the HVCRE rule to ensure that it is properly tailored, while still promoting economically responsible commercial lending.

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
S 2155 - Economic Growth, Regulatory Relief, and Consumer Protection Act

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