

Feds Ease Regulation of High Volatility Commercial Real Estate (HVCRE) Lending

By: [Matt Lubniewski](#)

On May 24, 2018, the [Economic Growth, Regulatory Relief, and Consumer Protection Act](#) (the Act) took effect and, among other things, eased some of the restrictions on bank lending involving what is referred to as high volatility commercial real estate (HVCRE). Starting in 2015, federally regulated depository institutions making loans for the acquisition, development, or construction (ADC) of commercial real estate were required to maintain 50% greater capital reserves for those loans than what is required for non-HVCRE loans. The requirement was imposed to offset the perceived risk to the capital adequacy of banks created by loans that financed speculative real estate projects. Certain ADC loans were excluded from the heightened capital requirements, including deals where (a) the loan-to-value ratio was below a certain threshold that varied based on the type of loan (e.g., 65% for raw land and 80% for commercial construction), (b) the borrower contributed capital to the project in the amount of at least 15% of the “as completed” value of the project, and (c) the borrower was contractually obligated to keep its contributed capital and all internally generated capital in the project for the life of the project. This particular exception to the HVCRE requirements has been a source of consternation for lenders, borrowers, and their lawyers ever since. The Act provides some clarity and relief for those closing ADC deals by amending the old requirements.

Appraised Value Now Counts as Contributed Capital

If land is used to satisfy a borrower’s 15% capital contribution requirement, the Act allows the appraised value of land to be considered in measuring the amount of the borrower’s capital contribution. Previously, only the cash the borrower paid for the land was counted. Now, if a borrower’s land has appreciated since it was acquired, the appreciated value now counts toward the 15% capital contribution requirement.

Types of Loans Triggering HVCRE Requirements Narrowed

The Act limits the types of loans for which banks need to carry higher capital reserves to what the Act now defines as “HVCRE ADC loans.” Previously, the capital requirements were triggered by any acquisition, development, or construction loan (absent one of the statutory exceptions). Now, the loan must “primarily” finance or refinance the acquisition, development, or construction of real property, the loan’s purpose must be to provide financing to acquire, develop, or improve real property into income-producing real property, and the repayment of the loan must be dependent on future income or sales proceeds from, or refinancing, of the real property. We expect federal regulators to elaborate on what it means for a loan to “primarily” finance ADC activities.

Loans Can Now Be Reclassified as Non-HVCRE ADC

HVCRE ADC loans can now be reclassified as Non-HVCRE ADC once the construction or development being financed is “substantially complete” and the project is generating cash flow sufficient to support debt service and property expenses. Previously, following loan origination, banks were only released from the increased capital requirements when the loan “convert[ed] to permanent financing.”

Borrowers Can Now Withdraw and Use Internally Generated Capital In Excess of the 15% Requirement

Borrowers can now use and withdraw capital that is internally generated by the project so long as the required 15% capital contribution remains satisfied. Previously, “internally generated” capital had to stay in the project “throughout the life of the project” for the HVCRE exception to apply. The Act eliminates this language. The statute still requires that the borrower be contractually required (by the loan documents) to keep the initial 15% contributed capital in the project until the loan is reclassified as Non-HVCRE ADC. The Act suggests that initially contributed capital in excess of the 15% minimum may be also withdrawn and used by the borrower, but the language is not clear. Hopefully, federal regulators will issue written guidance confirming their interpretation of the word “such” in this context, i.e., whether “such minimum amount of capital contributed” refers to (1) only the capital required to maintain the 15% contribution or (2) the entirety of the initially contributed capital.

HVCRE Exceptions for Projects with Sufficient Existing Cash Flow

The Act added two exceptions to the definition of HVCRE ADC Loan that relieve banks from the additional capital reserve requirements where the project is already producing income and the cash flow is sufficient to satisfy the bank’s underwriting criteria for permanent financings. One exception relates to acquisition and refinance loans and the other relates to construction loans.

Pre-2015 Loans Exempt

Loans made prior to January 1, 2015, are now expressly exempt from HVCRE capital reserve requirements. There is no need to carry additional capital reserves for pre-2015 loans that would be deemed HVCRE ADC loans if originated today.



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