HVCRE Update – December 2019

On December 13, 2019, the Agencies published the final rule regarding HVCRE (High Volatility Commercial Real Estate) which becomes effective on April 1, 2020. The primary intent of the revision was to create consistency with the statutory definition of HVCRE exposure. The revision will also provide for consistency in the reporting requirements for the Call Report and FR Y-9C.

The update includes a revised definition of HVCRE exposure generally consistent with the usage in other relevant regulations such as the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) and the Call Report. The revised rule also removes certain loans from the definition of an HVCRE exposure and therefore reduces the risk weight from 150 percent to 100 percent on some of the HVCRE loans held in portfolio.

HVCRE exposure is defined as:

1. A credit facility secured by land or improved real property, that prior to being reclassified by the depository institution as non-HVCRE exposure pursuant to paragraph (6)[1] of this definition.

Loans under this definition are generally further identified under a three-pronged approach

i. Primarily finances, has financed, or refinances the acquisition, development or construction of real property.
ii. Has the purpose of providing financing to acquire, develop or improve such real property into income producing real property; and
iii. Is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility;

The revised HVCRE exposure definition differs in primarily two ways:

1. Revised to apply to loans that "primarily" finance ADC (acquisition, development and construction) activities; and
2. The full appraised value of contributed land, less debt, as a part of the project can now count toward the 15% capital contribution.

It should be noted under the revised definition, a credit facility secured by land or improved real property should be interpreted in a manner that is consistent with the current definition of a loan secured by real estate in the Call Report and FR Y-9C instructions. This includes loans that are "primarily" (50% or more) secured by real estate.

Further clarifications include an exemption from HVCRE exposure for loans that finance 1-4 family residential structures. The HVCRE definition of 1-4 family loans is now aligned with the Call Report and FR Y-9C definition. The revised definition does not exempt loans provided primarily to finance land

[1] For the full definition and criteria for HVCRE exposure, please see Federal Register, Vol. 84, No. 240, Friday, December 13, 2019. https://www.govinfo.gov/content/pkg/FR-2019-12-13/pdf/2019-26544.pdf

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development activities for 1-4 family projects. Additionally, the revision clarifies condo and cooperative construction loans will qualify for the exclusion from HVCRE treatment. The exclusion is applied even if the loan is financing the construction of a building with 5 or more dwelling units if the repayment of the loan comes from the sale of individual condo or coop housing units.

Financial institutions may continue to apply the current methodology to the identification and accounting for HVCRE property until April 1, 2020. Institutions are permitted, but not required, to reclassify HVCRE loans that they currently hold to take advantage of the lower risk weight. If a loan is presently an HVCRE exposure, the loan will remain an HVCRE exposure until reclassified by the banking organization as a non-HVCRE exposure. After April 1, 2020, new loans that would have been classified as HVCRE but for this rule would receive a 100 percent risk weight instead of a 150 percent risk weight. The revised definition

The FDIC estimates the rule is likely to affect a substantial number of small, FDIC supervised institutions reducing the risk weight from 150 percent to 100 percent on some of the HVCRE loans held in the portfolio. Although the number of small institutions impacted will be great, the FDIC does anticipate a relatively small (less than 5%) reduction in risk-based capital.

Acquisition, construction and development loans generally have a greater risk profile comparatively with other types of traditional lending. The revised HVCRE exposure definition is an effort to capture those ADC loans that have increased risk characteristics. The revisions, while not a wholesale change, are important and meaningful for an institution to understand and adopt. These changes were driven by Section 214 of EGRRCPA which added section 51 to the Federal Deposit Insurance Act. Section 51 provides a statutory definition of HVCRE ADC loans. These changes will provide for further clarity in the identification of HVCRE and the consistency in reporting between depository institutions and holding companies.

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