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UPDATE: High Volatility Commercial Real Estate (HVCRE)

by Christopher W. Rosenbleeth

Without a doubt, for the past two-plus years, the hottest – and most disruptive – issue in commercial real estate finance has been the High Volatility Commercial Real Estate (HVCRE) rules. The HVCRE rules, which went into effect in January 2015 under the Dodd-Frank Wall Street Reform and Consumer Protection Act, generally require banks to set aside higher capital reserves for so-called "acquisition, construction and development" loans unless certain conditions are met. Prior to receiving any advance from a bank, developers must contribute at least 15 percent of a project's value in the form of cash or marketable securities, which capital must then remain invested until the loan is converted to permanent debt or paid in full.

In addition to the above requirements, the HVCRE rules established other parameters. First, the value of any contributed land could not be counted towards the 15 percent equity requirement. Second, borrowed money would not be counted – so a second mortgage or unsecured financing would not be included. Finally, the capital requirements for HVCRE loans stay in place until the loan is refinanced, even if the property becomes stabilized and is generating cash flow. In addition, the 15 percent equity requirement is based on the "as completed" value of a property – which can be far in excess of the cost of completion. This had the perverse result of stopping development deals dead in their tracks because an appraisal came in at a value that was *too high*! Overall, generally speaking, the HVCRE rules have resulted in reduced lending, fewer capital sources and/or higher pricing for borrowers.

On April 27, 2017, U.S. House of Representatives introduced legislation aimed at removing some of these restrictions. Among the changes, the new bill

- provides a more thorough definition of what constitutes a loan that is subject to HVCRE requirements;
- removes the all-cash equity requirement, subject to certain controls, like a compliant appraisal;
- provides parameters around when the HVCRE capital requirements would loosen following stabilization; and
- clarifies that loans for improvements to an existing cash-flowing property do not trigger HVCRE requirements.

The bipartisan bill, which is sponsored by Rep. Robert Pittenger, R-N.C., and Rep. David Scott, D-Ga., and has been widely lauded by industry groups, is expected to boost construction lending if passed.

We will continue to keep you apprised of any developments with respect to the rules and regulations regarding HVCRE loans.

Christopher W. Rosenbleeth

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