

## The Impact of US Basel III on the Acquisition, Development, and Construction of Commercial Real Estate

High-volatility commercial real estate (HVCRE) exposure is defined as  
**a credit facility that finances the acquisition, development, or construction (ADC) of real property.**

In 2013, federal banking agencies released the **US Basel III** final rule. These rules revise regulatory capital requirements for HVCRE, mandating that banking organizations maintain much higher capital levels. US Basel III also incorporates relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in an effort to strengthen the quantity and quality of regulatory capital.

Experts anticipate that by **this summer**, regulators will begin enforcing these rules in an effort to strengthen the quantity and quality of capital reserves. US Basel III will have wide-reaching impacts, specifically for the borrowers of commercial mortgages who build and own and operate multifamily and commercial properties. Given the significance of the banking sector on the industry, these regulatory capital changes could impact commercial real estate in numerous ways, including:

- Availability of capital to commercial real estate
- Higher cost of commercial mortgages
- Further shift away from relationship lending

### THE RESULT

Most banks will avoid having to recognize the ADC of property as HVCRE by requiring the sponsor/borrower/developer to:

- Contribute equity to the project **before** the bank
- Provide **15%** cash equity to the project, measured against the “as completed” value

### SUMMARY

Banks continue to be the greatest source of debt capital to the commercial real estate sector. The new regulatory capital rules under Basel III will increase the capital that banks must hold against their commercial mortgage exposures. The US Basel III final rule will replace the existing general risk-based capital rules, affecting more than 8,000 US banking institutions. These changes may negatively impact the availability and cost of debt.

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