DEPARTMENT OF TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3
Docket ID OCC-2018-0026
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FEDERAL RESERVE SYSTEM
12 CFR Part 217
[Regulation Q; Docket No. R-1621]
RIN 7100-AF15

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 324
RIN 3064-AF06

Regulatory Capital Rules: Treatment of Land Development Loans for the Definition of High Volatility Commercial Real Estate Exposure

AGENCY: Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the agencies) are issuing a notice of proposed rulemaking (proposal) to seek comment on the treatment of loans that finance the development of land for purposes of the one- to four-family residential properties exclusion in the definition of high volatility commercial real estate (HVCRE) exposure in the agencies' regulatory capital rule. This proposal expands upon the notice of proposed rulemaking (HVCRE NPR) issued on September 28, 2018, which proposed to revise the definition of HVCRE exposure in the regulatory capital rule to conform to the statutory definition of ''high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan,'' in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).

DATES: Comments must be received by [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

OCC: Mark Ginsberg, Senior Risk Expert, or Benjamin Pegg, Risk Expert, Capital and Regulatory Policy, (202) 649-6370; or Carl Kaminski, Special Counsel, or Rima Kundnani, Attorney, Chief Counsel's Office, (202) 649-5490, for persons who are deaf or hearing impaired, TTY, (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street, SW, Washington, DC 20219.

Board: Constance M. Horsley, Deputy Associate Director, (202) 452-5239; Elizabeth MacDonald, Manager, (202) 475-6216; Andrew Willis, Lead Financial Institutions Policy Analyst, (202) 912-4323; Matthew McQueeney, Senior Financial Institutions Policy Analyst (202) 452-2942; or Benjamin McDonough, Assistant General Counsel (202) 452-2036; David Alexander, Counsel, (202) 452-2877, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Benedetto Bosco, Chief, Capital Policy Section; bbosco@fdic.gov; David Riley, Senior Policy Analyst, Capital Policy Section; dariley@fdic.gov; Michael Maloney, Senior Policy Analyst, mmaloney@fdic.gov; regulatorycapital@fdic.gov; Capital Markets Branch, Division of Risk Management Supervision, (202) 898-6888; Beverlea S. Gardner, Senior Examination Specialist, bgardner@fdic.gov, Policy and Program Development; Michael Phillips, Counsel, mphillips@fdic.gov; or Catherine Wood, Acting Supervisory Counsel, cawood@fdic.gov; Supervision and Legislation Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

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I. Background

On September 28, 2018, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) published a notice of proposed rulemaking in the Federal Register (HVCRE NPR) to revise the high volatility commercial real estate (HVCRE) exposure definition in section 2 of the capital rule[1] to conform to the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan" in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[2]

[1] The Board and OCC issued a joint final rule on October 11, 2013 (78 FR 62018), and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). On April 14, 2014 (79 FR 20754), the FDIC adopted the interim final rule as a final rule with no substantive changes.

[2] See 12 CFR 217.2 (Board); 12 CFR 3.2 (OCC); 12 CFR 324.2 (FDIC). Section 214 of the EGRRCPA generally defines an HVCRE ADC Loan as a credit facility secured by land or improved real property that, primarily finances, has financed, or refinances the acquisition,

Consistent with section 214, the agencies proposed in the HVCRE NPR to exclude credit facilities that finance the acquisition, development, or construction of one- to four-family residential properties from the definition of HVCRE exposure. In the HVCRE NPR, the agencies also invited comment on whether it would be appropriate to include one-to four-family "lot development loans" within the scope of the one- to four-family residential properties exclusion from the definition of HVCRE exposure. Some commenters to the HVCRE NPR supported aligning the one- to four-family residential properties exclusion with the treatment of one- to four-family residential construction loans as reported in the Call Report and FR Y-9C. Other commenters to the HVCRE NPR supported the exclusion of lot development loans from the definition of HVCRE exposure.

After reviewing the comments related to lot development loans, the agencies believe that the regulatory capital treatment of such loans warrants further consideration and clarification before finalizing the definition of an HVCRE exposure. The term "lot development loan" is not defined in the capital rule. The agencies have considered the use of the term "lot development loan" or "land development loan" for purposes of the one-to-four-family residential properties exclusion to the definition of HVCRE exposure, and are proposing to use the term "land development," which is described in the instructions to the Call Report and FR Y-9C as a loan that finances the process of improving land, such as laying sewers, water pipes, and similar improvements to prepare the land for erecting new structures. Accordingly, the agencies are issuing this notice of proposed rulemaking (proposal), which expands upon the HVCRE NPR, to

development, or construction of real property; has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility.

seek comment on the treatment of land development loans for the purpose of the one- to four-family residential properties exclusion from the definition of HVCRE exposure.

Section 214 became effective upon enactment of the EGRRCPA. Accordingly, on July 6, 2018, the agencies issued a statement (interagency statement), advising banking organizations that, when determining which loans should be subject to a heightened risk weight, they may choose to continue to apply the current regulatory definition of HVCRE exposure, or they may choose to apply the heightened risk weight only to those loans they reasonably believe meet the definition of "HVCRE ADC loan" set forth in section 214 of the EGRRCPA.[3] Until the agencies take further action, banking organizations are advised to reference the interagency statement for purposes of the HVCRE exposure definition and regulatory reporting.

II. Summary of Proposal

The agencies are expanding the HVCRE NPR to revise the definition of HVCRE exposure in the capital rule by adding a new paragraph that provides that the exclusion for one- to four-family residential properties would not include credit facilities that solely finance land development activities, such as the laying of sewers, water pipes, and similar improvements to land, without any construction of one- to four-family residential structures. In order for a loan to be eligible for this exclusion, the credit facility would be required to include financing for construction of one- to four-family residential structures.

Credit facilities that combine the financing of land development and the construction of one- to four-family residential structures would qualify for the one- to four-family residential

[3] Board, FDIC, and OCC, *Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)*, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf. (last visited August 21, 2018).

properties exclusion. This revision would generally align with the instructions set forth in the Call Report and FR Y-9C on line 1.a.(1) of Schedules RC-C and HC-C. Further, combination land acquisition and construction loans on one- to four-family residential properties, regardless of the current stage of construction or development, would qualify for the one- to four-family residential properties exclusion as these exposures are reported in the Call Report and FR Y-9C on line 1.a.(1) of Schedules RC-C and HC-C. The agencies believe such combination loans generally pose less risk than loans that solely finance land development. Consistent with the HVCRE NPR, the proposal would maintain that "other land loans" (generally loans secured by vacant land, except for land known to be used for agricultural purposes) would continue to be included within the scope of the revised HVCRE exposure definition. Furthermore, under the proposal, combination land acquisition loans and land development loans that do not include financing for construction of one- to four-family residential structures, would not qualify for the one- to four-family residential properties exclusion. Under the proposal, a facility that solely finances land development would be categorized as an HVCRE exposure, unless the exposure meets another exclusion from the revised HVCRE exposure definition.

Allowing banking organizations to apply a consistent definition of one- to four-family residential property and land development in this manner would simplify reporting requirements, reduce burden, and promote uniform application of the capital rule. Additionally, supervisory experience has demonstrated that certain acquisition, development, and construction loan exposures present risks for which the agencies believe banking organizations should hold additional capital. Supervisors generally consider land development loans to present elevated risk as compared to construction loans. For example, while the loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan, the agencies have established in their real estate lending standards more stringent supervisory loan-to-value ratios for land development loans (75 percent) than for construction loans (80 or 85 percent depending on property type) because of the elevated credit risk in land development loans.[4] Furthermore, in some cases, land development loans may be made for speculative purposes, generate no cash flow, and require other sources of cash to service the debt. Based on the risks arising from land development loans, the agencies believe it would be imprudent to include loans that solely finance land development to prepare it for erecting new structures as part of the one- to four-family residential properties exclusion from the HVCRE exposure definition.

Consistent with the HVCRE NPR, the definition of HVCRE exposure would provide that the determination of whether a land development loan is considered an HVCRE exposure would be made at a loan's origination. Therefore, with respect to land development loans originated prior to the effective date of this rulemaking, the agencies would not expect banking organizations to reevaluate those exposures against the revised definition of HVCRE exposure. However, new land development loans originated after the effective date of this rulemaking would need to be evaluated in accordance with the revised HVCRE exposure definition for the purpose of the one- to four-family residential properties exclusion.

Question 1: The agencies invite comment on the exclusion of credit facilities that finance land development without any construction of one- to four-family residential structures from the one- to four-family residential properties exclusion in the HVCRE exposure definition. What are the advantages and disadvantages of not permitting such land development loans to qualify for

[4] See Board, OCC, and FDIC, *Interagency Guidelines For Real Estate Lending Policies* (real estate lending standards), 12 CFR Part 208 Appendix C (Board); 12 CFR part 34 Appendix A (OCC); 12 CFR part 365 Appendix A (FDIC).

the one- to four-family residential properties exclusion in the revised HVCRE exposure definition? The agencies welcome any quantitative analysis that could estimate the approximate economic impact of including or excluding such land development loans from the one- to four-family residential properties exclusion.

Question 2: The agencies invite comment on the proposed change to the rule text of the HVCRE exposure definition including whether it is sufficiently clear. What interpretation issues might arise from the proposed change to the HVCRE exposure definition? What additional clarity is needed to facilitate the consistent application of this proposed change to the rule text of the HVCRE exposure definition in the context of land development?

III. Regulatory Analyses

A. Paperwork Reduction Act

Certain provisions of the proposed rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521). In accordance with the requirements of the PRA, the agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number for the OCC is 1557-0318, Board is 7100-0313, and FDIC is 3064-0153. These information collections relate to the regulatory capital rules for each agency. However, the agencies expect that these information collections will not be affected by this proposed rule and therefore no submissions will be made under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and section 1320.11 of the OMB's implementing regulations (5 CFR 1320) for each of the agencies' regulatory capital rules.

The proposed rule also requires changes to the Call Reports (FFIEC 031, FFIEC 041, and FFIEC 051; OMB Nos. 1557-0081 (OCC), 7100-0036 (Board), and 3064-0052 (FDIC)) and Risk-Based Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101; OMB Nos. 1557-0239 (OCC), 7100-0319 (Board), and 3064-0159 (FDIC)), and Consolidated Financial Statements for Holding Companies (FR Y-9C; OMB No. 7100-0128), which will be addressed in separate *Federal Register* notices.

B. Regulatory Flexibility Act Analysis

OCC: The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, (RFA), requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the SBA for purposes of the RFA to include commercial banks and savings institutions with total assets of $550 million or less and trust companies with total assets of $38.5 million of less) or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities.

As of June 30, 2018, the OCC supervises 886 small entities.[5]

The proposed rule applies to all OCC-supervised depository institutions. Currently, 211 small OCC-supervised institutions report HVCRE exposures. Therefore, the rule will affect a substantial number of small entities. However, the OCC does not find that the impact of this proposed rule will be economically significant.

Therefore, the OCC certifies that the proposed rule will not have a significant economic impact on a substantial number of OCC-supervised small entities.

[5] The OCC calculated the number of small entities using the SBA’s size thresholds for commercial banks and savings institutions, and trust companies, which are $550 million and $38.5 million, respectively. Consistent with the General Principles of Affiliation, 13 CFR 121.103(a), the OCC counted the assets of affiliated financial institutions when determining whether to classify a national bank or Federal savings association as a small entity.

The proposed rule impacts two principal areas: (1) the capital impact associated with implementing revisions to the one- to four-family residential properties exclusion in the revised HVCRE exposure definition and, (2) the impact associated with the time required to update policies and procedures. As described in the Supplementary Information section in the preamble to this proposed rule, the OCC believes the change to the treatment of land development loans for the purpose of the one- to four-family residential properties exclusion in the definition of HVCRE exposure will result in an increase in future required capital, once existing HVCRE land development loans roll over. This is because the proposed rule does not require re-evaluation of existing land development loans and would only apply to newly issued land development loans after the effective date of this rulemaking. This will serve to minimize the compliance burden for OCC-supervised entities. The OCC finds that the amount of total capital that small OCC-supervised institutions would need in the future in order to maintain their total risk-based capital ratios, as of March 31, 2018, would increase by approximately $33.97 million.

In addition to facing increased capital requirements, OCC-supervised banks may face one-time compliance costs associated with updating policies and procedures to identify whether a newly issued land development loan is eligible for the one- to four-family residential properties exclusion in the revised HVCRE exposure definition. Based on the OCC's supervisory experience, OCC staff estimates that it would take an OCC-supervised institution, on average, a one-time investment of one business day, or 8 hours, to update policies and procedures to identify whether a newly issued land development loan is eligible for the one- to four-family residential properties exclusion in the revised HVCRE exposure definition.

The OCC's threshold for a significant effect is whether cost increases associated with a rule are greater than or equal to either 5 percent of a small bank's total annual salaries and benefits or 2.5 percent of a small bank's total non-interest expense. OCC-supervised institutions would incur an estimated one-time compliance cost of $912 per institution (8 hours × $114 per hour).[6] OCC staff finds that the overall impact, which includes the future increase in required capital and the cost of complying with the proposed rule, will not exceed either of the thresholds for a significant impact on any OCC-supervised small entities.

For this reason, the OCC certifies that the proposed rule will not have a significant economic impact on a substantial number of OCC-supervised small entities.

Board: The RFA requires an agency to either provide an initial regulatory flexibility analysis with a proposal or certify that the proposal will not have a significant impact on a substantial number of small entities. Under regulations issued by the SBA, a small entity includes a bank, bank holding company, or savings and loan holding company with assets of $550 million or less (small banking organization).[7] On average during 2018, there were approximately 3,191 small bank holding companies, 204 small savings and loan holding companies, and 549 small state member banks.

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. A final regulatory flexibility analysis will be conducted after comments received during the public comment period have been considered.

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[6] Under the assumption that banks would need twice the amount of time to update policies and procedures, the estimated compliance cost is $1,824 per institution (16 hours x $114 per hour).

[7] See 13 CFR 121.201. Effective July 14, 2014, the SBA revised the size standards for banking organizations to $550 million in assets from $500 million in assets. 79 FR 33647 (June 12, 2014).

The Board welcomes comment on all aspects of its analysis. In particular, the Board requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

As discussed in this Supplementary Information, the Board has proposed to revise the definition of HVCRE exposure to conform to the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan," in accordance with section 214 of EGRRCPA. The proposal would clarify that certain land development loans as defined in the Call Report and FR Y-9C instructions are included in the revised definition of HVCRE exposure.

The proposal would apply to all state member banks, as well as all bank holding companies and savings and loan holding companies that are subject to the Board's capital rule. Certain bank holding companies, and savings and loan holding companies are excluded from the application of the Board's capital rule. In general, the Board's capital rule only applies to bank holding companies and savings and loan holding companies that are not subject to the Board's Small Bank Holding Company and Savings and Loan Holding Company Policy Statement, which applies to bank holding companies and savings and loan holding companies with less than $3 billion in total assets that also meet certain additional criteria.[8] Thus, most bank holding companies and savings and loan holding companies that would be subject to the proposed rule exceed the $550 million asset threshold at which a banking organization would qualify as a small banking organization.

In assessing whether the proposal rule would have a significant impact on a substantial number of small entities, the Board has considered the proposal's capital impact as well as its

[8] See 12 CFR 217.1(c)(1)(ii) and (iii); 12 CFR part 225, appendix C; 12 CFR 238.9.

compliance, administrative, and other costs. As of December 31, 2018, there were 157 small state member banks and three small bank or savings and loan holding companies that reported combined HVCRE exposures totaling $611 million and 1-4 family residential construction loans totaling $1.2 billion. To estimate the capital impact of the proposal, the Board assumed a range of 75 to 95 percent of 1-4 family residential construction loans would remain exempt from the revised definition of HVCRE exposure. Based on this assumption, the difference in required capital would be in the range of $7 million to $36 million for small banking organizations supervised by the Board.

In addition to capital impact, the Board has considered whether the compliance, administrative, and other costs associated with the proposed rule. Given that the proposed rule does not impact the recordkeeping and reporting requirements that affected small banking organizations are currently subject to, there would be no change to the information that small banking organizations must track and report. Some small banking organizations may incur costs associated with updating internal policies to reflect the revised definition of HVCRE exposure, including the treatment of land development loans. However, because the proposal would clarify the treatment of HVCRE exposure and land development loans that may currently be in effect at many small banking organizations, the Board does not anticipate that a substantial number of small banking organizations will incur significant costs to update internal systems or policies to reflect the revised HVCRE exposure definition.

The Board does not believe that the proposed rule duplicates, overlaps, or conflicts with any other Federal rules. In addition, there are no significant alternatives to the proposed rule. In light of the foregoing, the Board does not believe that the proposed rule, if adopted in final form, would have a significant economic impact on a substantial number of small entities.

FDIC: The RFA generally requires that, in connection with a proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis describing the impact of the proposed rule on small entities.[9] However, a regulatory flexibility analysis is not required if the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. The SBA has defined "small entities" to include banking organizations with total assets of less than or equal to $550 million that are independently owned and operated or owned by a holding company with less than or equal to $550 million in total assets.[10] Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or 2.5 percent of total non-interest expenses. The FDIC believes that effects in excess of these thresholds typically represent significant effects for FDIC-supervised institutions. For the reasons described below and under section 605(b) of the RFA, the FDIC certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities.

The FDIC supervises 3,489 depository institutions,[11] of which 2,674 are considered small entities for the purposes of RFA.[12] According to recent data, 2,145 small, FDIC-supervised institutions report holding some volume of ADC loans for one- to four- family residential

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[9] 5 U.S.C. 601 et seq.

[10] The SBA defines a small commercial bank to have $550 million or less in total assets. See 13 CFR 121.201 (as amended, effective December 2, 2014). The SBA requires agencies to "consider assets of affiliated and acquired financial institutions reported in the previous four quarters." See 13 CFR 121.104. Therefore, the FDIC utilizes merger-adjusted and affiliated assets, averaged over the previous four quarters, to identify whether a bank is a "small entity" for the purposes of RFA.

[11] FDIC-supervised institutions are set forth in 12 U.S.C. 1813(q)(2).

[12] FDIC Call Report, December 31st, 2018.

properties. Therefore, the FDIC estimates that the proposed rule is likely to affect a substantial number, 2,145 (80.2 percent), of small, FDIC-supervised institutions.[13]

This proposed rule would require institutions to treat some future land development loans for one- to four-family residential properties as HVCRE, which means they would receive a risk weight of 150 percent rather than 100 percent, unless such loans would qualify for a different exclusion. Based on comments received by the agencies, there is some uncertainty about the treatment for certain land development loans under the proposed definition of HVCRE. This proposed rule clarifies the treatment for certain land development loans and is likely to result in increased risk-weighted assets, and therefore increased risk-based capital requirements, for affected institutions. The effects of the proposed rule will be realized over the ensuing years by affected institutions as they make more land development loans. The Call Report does not collect data on land development loans in a standalone line item. However, such loans would be included in the category of one- to four-family residential construction loans on Schedule RC-C Line 1.a(1) if they include financing for the construction of one- to four-family residential structures. Residential mortgage exposures receive a 50 percent risk weight if they are secured by prudently-underwritten first liens on one- to four-family residential properties, while other residential mortgage exposures receive a 100 percent risk weight.[14] Therefore, the 100 percent risk weight category of residential mortgage exposures includes land development loans, other construction loans, as well as credit lines secured by home equity and mortgage loans secured by junior liens on one- to four-family residential properties. The potential effects of the proposed increase in risk-weight treatment for certain land development loans is difficult to quantify as it

[13] Id.
[14] 78 FR 55340

depends on the future volume of such lending. Assuming that current loan volume is an accurate proxy for future lending activity, to determine the maximum potential capital effect of the proposed rule, the FDIC assumes that all construction loans currently reported by FDIC-supervised institutions that are secured by one- to four-family residential properties are land development loans. The FDIC also assumes that the ratio of currently reported residential construction loans to currently reported total residential mortgage loans (other than those secured by first liens of one- to four-family residential properties) is the same for each institution's 100 percent risk-weight category of residential mortgage exposures as it is for each institution's loan portfolio, and that covered institutions would maintain the same risk-based capital ratio after the proposed rule goes into effect. Using those assumptions, the FDIC finds that the amount of total capital that small FDIC-supervised institutions would need in the future in order to maintain their current total risk-based capital ratios would increase by $259.20 million (0.50 percent); the amount of tier 1 capital institutions would need in order to maintain their current tier 1 risk-based capital ratios would increase by $242.8 million (0.50 percent); and the amount of common equity tier 1 capital institutions would need in order to maintain their current common equity tier 1 risk-based capital ratios would increase by $242.5 million (0.50 percent). The maximum estimated potential future capital increase of $259.20 million for small, FDIC-supervised institutions consistent with maintaining their current risk-based capital ratios, amounts to an average increase in capital of $120,839 per affected institution.[15]

The change in required capital precipitated by the proposed rule will almost certainly be less than the maximum estimated amount, since not all current credit facilities that finance land development without any construction of one- to four-family residential properties would qualify

[15] FDIC Call Report, December 31st, 2018.

for a higher risk weight. The estimated maximum increase in capital would represent less than five percent of total current risk-based capital for all but 30 small FDIC-supervised institutions, and less than ten percent of risk-based capital for all but 11 FDIC-supervised institutions.[16] Since land development loans are not reported separately on the Call Report, they could comprise anywhere from zero to 100 percent of residential construction loans for each institution.

The proposed rule could pose some administrative costs for covered institutions associated with reviewing land development loan portfolios. It is difficult to accurately estimate the costs that each institution will incur in order to conduct reviews since it depends on each institution's volume of land development loans. However, assuming that each institution requires 40 hours of labor to adopt new policies and procedures for reviewing new lot development loans, and assuming an hourly cost of $83.23,[17] the estimated administrative costs resulting from this proposal would be $3,329.20 per institution or $7,141,134 for all small, FDIC-supervised institutions. These administrative costs amount to less than two percent of annualized salary expense, and less than one percent of annualized noninterest expense, for all small, FDIC-supervised institutions directly affected by the proposed rule.[18] Therefore, this aspect of the proposed rule does not have a significant effect on small, FDIC-supervised institutions directly affected by the proposed rule.

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[16] Id.

[17] Estimated total hourly compensation of Financial Analysts in the Depository Credit Intermediation sector as of December 2018. The estimate includes the May 2017 75th percentile hourly wage rate reported by the Bureau of Labor Statistics, National Industry-Specific Occupational Employment, and Wage Estimates. This wage rate has been adjusted for changes in the Consumer Price Index for all Urban Consumers between May 2017 and December 2018 (3.59 percent) and grossed up by 50.83 percent to account for non-monetary compensation as reported by the December 2018 Employer Costs for Employee Compensation Data.

[18] FDIC Call Report, December 31st, 2018.

This proposed rule would likely increase capital requirements for some land development loans, which could potentially decrease the volume of this type of lending by small, FDIC-supervised institutions. The FDIC believes that this effect will likely be small given that the amendments only affect a subset of residential construction loans, which represent a small portion of total assets for most small, FDIC-supervised institutions. Going forward, institutions also could have an incentive to shift their loan mix away from credit facilities that finance land development without any construction of one- to four-family residential properties. Increases in required capital could enhance the ability of small, FDIC-supervised institutions to withstand an economically stressful scenario. This effect would only be relevant for a small number of institutions with material exposures to the types of loans covered by the proposed rule.

The baseline for analysis of the expected effects of the proposed rule on small entities is the current regulatory definition of HVCRE and the interagency statement.[19] However, as described previously, this NPR expands upon the HVCRE NPR. The HVCRE NPR revises the definition of HVCRE exposure in the regulatory capital rule to conform to the statutory definition of ''high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan,'' in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). If the total expected effects of the proposed rule and the HVCRE NPR were considered together they are likely to result in a reduction in risk weighted assets for affected institutions.

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[19] Board, FDIC, and OCC, *Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)*, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf. (last visited August 21, 2018).

Based on this supporting information, the FDIC does not believe that the proposed rule will have a significant economic impact on a substantial number of small entities.

The FDIC invites comments on all aspects of the supporting information provided in this section, and in particular, whether the proposed rule would have any significant effects on small entities that the FDIC has not identified.

C. Plain Language

Section 722 of the Gramm-Leach-Bliley Act[20] requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the proposed rule in a simple and straightforward manner, and invite comment on the use of plain language. For example:

• Have the agencies organized the material to suit your needs? If not, how could they present the proposed rule more clearly?

• Are the requirements in the proposed rule clearly stated? If not, how could the proposed rule be more clearly stated?

• Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?

• Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would achieve that?

• Would more, but shorter, sections be better? If so, which sections should be changed?"

[20] Pub. L. 106-102, section 722, 113 Stat. 1338, 1471 (1999).

• What other changes can the agencies incorporate to make the regulation easier to understand?

D. OCC Unfunded Mandates Reform Act of 1995 Determination

The OCC analyzed the proposed rule under the factors set forth in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the rule includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). The OCC has determined that this rule will not result in expenditures by State, local, and Tribal governments, or the private sector, of $100 million or more in any one year. Accordingly, the OCC has not prepared a written statement to accompany this proposed rule.

E. Riegle Community Development and Regulatory Improvement Act of 1994

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),[21] in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository

[21] 12 U.S.C. 4802(a).

institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.[22]

The agencies note that comment on these matters has been solicited in other sections of this Supplementary Information section, and that the requirements of RCDRIA will be considered as part of the overall rulemaking process. In addition, the agencies also invite any other comments that further will inform the agencies' consideration of RCDRIA.

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Banks, Banking, Capital adequacy, Capital requirements, Asset Risk-weighting methodologies, Reporting and recordkeeping requirements, National banks, Federal savings associations, Risk.

12 CFR Part 217

Administrative practice and procedure, Banks, Banking, Capital adequacy, Capital requirements, Asset Risk-weighting methodologies, Reporting and recordkeeping requirements, Holding companies, State member banks, Risk.

12 CFR Part 324

Administrative practice and procedure, Banks, Banking, Capital adequacy, Capital requirements, Asset Risk-weighting methodologies, Reporting and recordkeeping requirements, State savings associations, State non-member banks, Risk.

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[22] Id.

Office of the Comptroller of the Currency

For the reasons set out in the Supplementary Information, the OCC is amending 12 CFR part 3 as follows.

PART 3 – CAPITAL ADEQUACY STANDARDS

1. The authority citation for Part 3 continues to read as follows:

AUTHORITY: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

2. Amend § 3.2 by revising the definition of a "high volatility commercial real estate (HVCRE) exposure" as follows:

§3.2 Definitions.

* * * * *

High volatility commercial real estate (HVCRE) exposure means:

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

(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;

(2) Does not include a credit facility financing—

(i) The acquisition, development, or construction of properties that are—

(A) One- to four-family residential properties;

(B) Real property that would qualify as an investment in community development; or

(C) Agricultural land;

(ii) The acquisition or refinance of existing income-producing real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the national bank's or Federal savings association's applicable loan underwriting criteria for permanent financings;

(iii) Improvements to existing income-producing improved real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the national bank's or Federal savings association's applicable loan underwriting criteria for permanent financings; or

(iv) Commercial real property projects in which—

(A) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio as determined by the OCC;

(B) The borrower has contributed capital of at least 15 percent of the real property's appraised, 'as completed' value to the project in the form of—

(*1*) Cash;

(*2*) Unencumbered readily marketable assets;

(*3*) Paid development expenses out-of-pocket; or

(*4*) Contributed real property or improvements; and

(C) The borrower contributed the minimum amount of capital described under paragraph (2)(iv)(B) of this definition before the national bank or Federal savings association advances funds (other than the advance of a nominal sum made in order to secure the national bank's or Federal savings association's lien against the real property) under the credit facility, and such minimum amount of capital contributed by the borrower is contractually required to remain in the project until the HVCRE exposure has been reclassified by the national bank or Federal savings association as a non-HVCRE exposure under paragraph (6) of this definition;

(3) Does not include any loan made prior to January 1, 2015; and

(4) Does not include a credit facility reclassified as a non-HVCRE exposure under paragraph (6) of this definition.

(5) *Value Of Contributed Real Property*.—For the purposes of this HVCRE exposure definition, the value of any real property contributed by a borrower as a capital contribution shall be the appraised value of the property as determined under standards prescribed pursuant to section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3339), in connection with the extension of the credit facility or loan to such borrower.

(6) *Reclassification As A Non-HVCRE exposure*.—For purposes of this HVCRE exposure definition and with respect to a credit facility and a national bank or Federal savings association, a national bank or Federal savings association may reclassify an HVCRE exposure as a non-HVCRE exposure upon—

(i) The substantial completion of the development or construction of the real property being financed by the credit facility; and

(ii) Cash flow being generated by the real property being sufficient to support the debt service and expenses of the real property, in accordance with the national bank's or Federal savings association's applicable loan underwriting criteria for permanent financings.

(7) For purposes of this definition, credit facilities that do not finance the construction of one- to four-family residential structures, but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, do not qualify for the one- to four-family residential properties exclusion in paragraph 2(i)(A).

* * * * *

Board of Governors of the Federal Reserve System

For the reasons set out in the Supplementary Information, part 217 of chapter II of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q).

* * * * *

Subpart A—General Provisions

3. The authority citation for part 217 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909,4808, 5365, 5368, 5371.

4. Section 217.2 is amended by revising the definition of a “high volatility commercial real estate (HVCRE) exposure” as follows:

§217.2 Definitions.

* * * * *

High volatility commercial real estate (HVCRE) exposure means:

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

(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; provided that:

(2) An HVCRE exposure does not include a credit facility financing—

(i) The acquisition, development, or construction of properties that are—

(A) One- to four-family residential properties;

(B) Real property that would qualify as an investment in community development; or

(C) Agricultural land;

(ii) The acquisition or refinance of existing income-producing real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the Board-regulated institution's applicable loan underwriting criteria for permanent financings;

(iii) Improvements to existing income-producing improved real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the Board-regulated institution's applicable loan underwriting criteria for permanent financings; or

(iv) Commercial real property projects in which—

(A) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio as determined by the Board;

(B) The borrower has contributed capital of at least 15 percent of the real property's appraised, 'as completed' value to the project in the form of—

(*1*) Cash;

(*2*) Unencumbered readily marketable assets;

(*3*) Paid development expenses out-of-pocket; or

(*4*) Contributed real property or improvements; and

(C) The borrower contributed the minimum amount of capital described under paragraph (2)(iv)(B) of this definition before the Board-regulated institution advances funds (other than the advance of a nominal sum made in order to secure the Board-regulated institution's lien against the real property) under the credit facility, and such minimum amount of capital contributed by the borrower is contractually required to remain in the project until the HVCRE exposure has been reclassified by the Board-regulated institution as a non-HVCRE exposure under paragraph (6) of this definition;

(3) An HVCRE exposure does not include any loan made prior to January 1, 2015;

(4) An HVCRE exposure does not include a credit facility reclassified as a non-HVCRE exposure under paragraph (6).

(5) *Value of contributed real property*. For the purposes of this definition of HVCRE exposure, the value of any real property contributed by a borrower as a capital contribution is the appraised value of the property as determined under standards prescribed pursuant to section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3339), in connection with the extension of the credit facility or loan to such borrower.

(6) *Reclassification as a non-HVCRE exposure*. For purposes of this definition of HVCRE exposure and with respect to a credit facility and a Board-regulated institution, a Board-regulated institution may reclassify an HVCRE exposure as a non-HVCRE exposure upon—

(i) The substantial completion of the development or construction of the real property being financed by the credit facility; and

(ii) Cash flow being generated by the real property being sufficient to support the debt service and expenses of the real property, in accordance with the Board-regulated institution's applicable loan underwriting criteria for permanent financings.

(7) For purposes of this definition, credit facilities that do not finance the construction of one- to four-family residential structures, but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, do not qualify for the one- to four-family residential properties exclusion in paragraph 2(i)(A).

12 CFR Part 324

Federal Deposit Insurance Corporation

For the reasons set out in the Supplementary Information, the FDIC proposes to amend 12 CFR part 324 as follows.

PART 324 – CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS

Subpart A—General Provisions

5. The authority citation for part 324 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat.

2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111–203, 124 Stat. 1376, 1887 (15 U.S.C. 78o–7 note).

6. Section 324.2 is amended by revising the definition of a "high volatility commercial real estate (HVCRE) exposure" as follows:

§324.2 Definitions.

*   *   *   *   *

High volatility commercial real estate (HVCRE) exposure means:

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

(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; provided that:

(2) An HVCRE exposure does not include a credit facility financing—

(i) The acquisition, development, or construction of properties that are—

(A) One- to four-family residential properties;

(B) Real property that would qualify as an investment in community development; or

(C) Agricultural land;

(ii) The acquisition or refinance of existing income-producing real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the FDIC-supervised institution's applicable loan underwriting criteria for permanent financings;

(iii) Improvements to existing income-producing improved real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the FDIC-supervised institution's applicable loan underwriting criteria for permanent financings; or

(iv) Commercial real property projects in which—

(A) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio as determined by the FDIC;

(B) The borrower has contributed capital of at least 15 percent of the real property's appraised, 'as completed' value to the project in the form of—

(*1*) Cash;

(*2*) Unencumbered readily marketable assets;

(*3*) Paid development expenses out-of-pocket; or

(*4*) Contributed real property or improvements; and

(C) The borrower contributed the minimum amount of capital described under paragraph (2)(iv)(B) of this definition before the FDIC-supervised institution advances funds (other than the advance of a nominal sum made in order to secure the FDIC-supervised institution's lien against the real property) under the credit facility, and such minimum amount of capital contributed by the borrower is contractually required to remain in the project until the HVCRE exposure has been reclassified by the FDIC-supervised institution as a non-HVCRE exposure under paragraph (6) of this definition;

(3) An HVCRE exposure does not include any loan made prior to January 1, 2015;

(4) An HVCRE exposure does not include a credit facility reclassified as a non-HVCRE exposure under paragraph (6).

(5) Value Of contributed real property.—For the purposes of this definition of HVCRE exposure, the value of any real property contributed by a borrower as a capital contribution is the appraised value of the property as determined under standards prescribed pursuant to section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3339), in connection with the extension of the credit facility or loan to such borrower.

(6) Reclassification as a non-HVCRE exposure.—For purposes of this definition of HVCRE exposure and with respect to a credit facility and an FDIC-supervised institution, an FDIC-supervised institution may reclassify an HVCRE exposure as a non-HVCRE exposure upon—

(i) The substantial completion of the development or construction of the real property being financed by the credit facility; and

(ii) Cash flow being generated by the real property being sufficient to support the debt service and expenses of the real property, in accordance with the FDIC-supervised institution's applicable loan underwriting criteria for permanent financings.

(7) For purposes of this definition, credit facilities that do not finance the construction of one- to four-family residential structures, but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, do not qualify for the one- to four-family residential properties exclusion in paragraph 2(i)(A).

[THIS SIGNATURE PAGE RELATES TO THE JOINT RULEMAKING TITLED “REGULATORY CAPITAL TREATMENT OF CERTAIN LAND DEVELOPMENT LOANS FOR THE DEFINITION OF HIGH VOLATILITY COMMERCIAL REAL ESTATE EXPOSURES.”]

Dated: 6/10/19

(signed)

Joseph M. Otting
Comptroller of the Currency

[THIS SIGNATURE PAGE RELATES TO THE JOINT RULEMAKING TITLED "REGULATORY CAPITAL TREATMENT OF CERTAIN LAND DEVELOPMENT LOANS FOR THE DEFINITION OF HIGH VOLATILITY COMMERCIAL REAL ESTATE EXPOSURES."]

By order of the Board of Governors of the Federal Reserve System, June 11, 2019.

(signed)

Ann E. Misback,
Secretary of the Board.

[THIS SIGNATURE PAGE RELATES TO THE JOINT RULEMAKING TITLED "REGULATORY CAPITAL TREATMENT OF CERTAIN LAND DEVELOPMENT LOANS FOR THE DEFINITION OF HIGH VOLATILITY COMMERCIAL REAL ESTATE EXPOSURES."]

Dated at Washington, D.C., on June 7, 2019.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

(Signed)

Robert E. Feldman,
Executive Secretary.