CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 6, 2017

H.R. 2148
Clarifying Commercial Real Estate Loans

As ordered reported by the House Committee on Financial Services on October 12, 2017

H.R. 2148 would revise the current requirement that banks hold more capital for high-volatility commercial real estate (HVCRE) loans. HVCRE loans are a subset of acquisition, development, and construction (ADC) loans, which banks make to borrowers who wish to purchase and improve real property. Under the bill, regulators could permit banks to hold between 8 percent and 10.4 percent of capital for certain new HVCRE loans instead of the 10.4 percent proposed by bank regulators. The effect of H.R. 2148 would be to exempt loans from the increased capital requirements if borrowers contribute resources, land, or property that is worth at least 15 percent of the appraised value of the financed property. Those loans are called contributed capital loans.

The bill would apply only to new HVCRE loans. Banks do not currently report the value of contributed capital loans to regulators, so the value of new loans subject to the exemption is uncertain. In addition, depending on future regulations, banks might change the way they structure those loans, or, if the capital requirements were perceived as too onerous, banks might stop making such loans altogether.

On the basis of publicly available data from bank balance sheets, CBO estimates that banks currently hold about $315 billion in ADC loans, which amounts to about 2 percent of their total assets. In CBO's baseline projections, bank assets grow by roughly 5 percent each year over the 2018-2027 period. CBO expects that the value of ADC loans will grow in line with other assets and thus ADC loans would constitute roughly 2 percent of those additional assets.

Banks now must hold 8 percent of the value of ADC loans that are not determined to be HVCRE loans in capital reserves. Under regulations proposed in September, banks would need to increase the reserve amount to 10.4 percent for loans that were subject to the additional-capital requirement.[1] CBO estimates that about one-quarter of ADC loans are exempt from the additional-capital requirement because they finance construction of properties that include between one and four family residences. Because it is unknown whether that new rule will become final under current law, CBO has assigned a

1. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies Propose Simplifying Regulatory Capital Rules," NR 2017-111 (press release, September 27, 2017), https://go.usa.gov/xnT6j.

50 percent chance that the capital reserve requirement will increase to 10.4 percent for those loans for the purpose of estimating future reserve requirements in its baseline.

CBO estimates that, under the bill, banks' total capital reserves would be diminished by less than one one-thousandth of a percent (0.001 percent) relative to their reserves under current law.[2] Changes in the amount of capital that a bank holds can affect its probability of failure, which in turn can impose costs on the Deposit Insurance Fund (administered by the Federal Deposit Insurance Corporation). Those costs are recorded in the budget as increases in direct spending. However, because that estimated change is so small, CBO expects that there would be a very small probability of an increase in bank defaults resulting from the bill. Thus, CBO estimates that enacting H.R. 2148 would not have a significant effect on direct spending over the 2018-2027 period.

Because enacting the bill would affect direct spending, pay-as-you-go procedures apply. Enacting the bill would not affect revenues.

CBO estimates that enacting H.R. 2148 would not significantly increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2028.

H.R. 2148 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

H.R. 2148 could impose a private-sector mandate, as defined in UMRA. A mandate would not occur if regulations proposed by the Federal Reserve in September were to become final because this bill would narrow the population of banks affected by capitalization requirements. If, however, the regulations are not finalized, the bill would broaden the population of banks affected by requirements relative to current law. In that case, some banks would need to meet higher capital requirements. Because of uncertainty about how those banks would respond and the lack of data about the value of new loans, CBO is unable to determine whether the costs of a private-sector mandate under such scenario would exceed the threshold established in UMRA ($156 million in 2017, adjusted annually for inflation).

The CBO staff contacts for this estimate are Sarah Puro (for federal costs) and Rachel Austin (for mandates). The estimate was approved by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

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2. The estimated change in capital reserve requirements equals: 2 percent of new bank assets (for ADC loans) × 75.0 percent (to exclude construction loans that include between one and four family residences) × 2.4 percent (the decrease in capital required under the bill relative to the proposed rule) × 50.0 percent (because of the uncertainty about the proposed increase in the reserve requirement under current law), divided by 100 percent of the banks' total capital reserves.