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All Commercial Banks  
(excluding RRBs )

Dear Sir,

**Guidelines on Classification of Exposures as  
Commercial Real Estate (CRE) Exposures**

Please refer to our circular [DBS.CO.PP.BC.21/11.01.005/2004-05](#) dated June 29, 2005 on the captioned subject, inter alia, defining CRE Exposures.

2. In view of a number of queries received from banks and other quarters as to whether or not certain exposures should be treated as CRE Exposures, as also in the light of switching over to Basel-II Framework which has specific provisions relating to such exposures, it was decided to review the definition of CRE Exposure. Draft guidelines were placed twice on the RBI website vide our circulars DBOD.BP.No. 11021/08.12.015/2008-09 dated January 7, 2009 and [DBOD.BP.No.502/ 08.12.015/ 2008-09](#) dated July 7, 2009, respectively, for comments of banks and general public.

3. After duly considering the comments and suggestions received, final guidelines on classification of CRE Exposures are now given in the Annex. It may be clarified that the guidelines are based on principles and the examples given in Appendix 2 are illustrative and not exhaustive. Based on the principles and the examples, banks should be able to determine whether an exposure is CRE or not and should record a reasoned note justifying the classification. Further, it is possible that an exposure could have multiple classifications, such as CRE, Infrastructure Lending, Capital Market Exposure, etc. In that case, in all regulatory reporting to the Reserve Bank, the exposure should be reported under all relevant classifications, with a footnote to avoid double counting, and would attract all regulatory concessions and limits, if any, applicable to the classifications.

4. The guidelines contained in this circular would be applicable with immediate effect.

Yours faithfully

(B. Mahapatra)  
Chief General Manager

Guidelines on Commercial Real Estate (CRE) Exposure

**1. Definition of CRE Exposure**

1.1 Real Estate is generally defined as an immovable asset - land (earth space) and the permanently attached improvements to it. Income-producing real estate (IPRE) has been defined in para 226 of the Basel-II Framework, which is reproduced below:

*"Income-producing real estate (IPRE) refers to a method of providing funding to real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. The primary source of these cash flows would generally be lease or rental payments or the sale of the asset. The borrower may be, but is not required to be, an SPE (Special Purpose Entity), an operating company focused on real estate construction or holdings, or an operating company with sources of revenue other than real estate. The distinguishing characteristic of IPRE versus other corporate exposures that are collateralised by real estate is the strong positive correlation between the prospects for repayment of the exposure and the prospects for recovery in the event of default, with both depending primarily on the cash flows generated by a property".*

1.2 From the definition of IPRE given above it may be seen that for an exposure to be classified as IPRE/CRE, the essential feature would be that the funding will result in the creation / acquisition of real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment would depend primarily on the cash flows generated by the asset. Additionally, the prospect of recovery in the event of default would also depend primarily on the cash flows generated from such funded asset which is taken as security, as would generally be the case. The primary source of cash flow (i.e. more than 50% of cash flows) for repayment would generally be lease or rental payments or the sale of the assets as also for recovery in the event of default where such asset is taken as security.

1.3 These guidelines will also be applicable to certain cases where the exposure may not be directly linked to the creation or acquisition of CRE but the repayment would come from the cash flows generated by CRE. For example, exposures taken against existing commercial real estate whose prospects of repayments primarily depend on rental/ sale proceeds of the real estate should be classified as CRE. Other such cases may include: extension of guarantees on behalf of companies engaged in commercial real estate activities, exposures on account of derivative transactions undertaken with real estate companies, corporate loans extended to real estate companies and investment made in the equity and debt instruments of real estate companies.

## **2. Approach followed by RBI**

2.1 The definition of Commercial Real Estate exposure is closely aligned to Basel II definition and would be as at para 1.2 to 1.3 above. It follows that if the repayment primarily depends on other factors such as operating profit from business operations, quality of goods and services, tourist arrivals etc., the exposure would not be counted as Commercial Real Estate.

2.2 As regards financing of land acquisition by banks the extant instructions are contained in our [Master Circular DBOD. No. DIR. \(HSG\). BC.08/08.12.01 /2009-10](#) dated July 1, 2009 on Housing Finance. In terms of this circular, banks may extend finance to public agencies, and not to private builders, for acquisition and development of land provided it is a part of the complete project including development of infrastructure such as water systems, drainage, roads, provision of electricity, etc. In terms of the above circular, where land is acquired and developed by State Housing Boards and other public agencies, banks may extend credit to private builders on commercial terms by way of loans linked to each specific project. However, banks are not permitted to extend fund based or non fund based facilities to private builders for acquisition of land even as part of a housing project.

Bank finance can also be granted to individuals for purchase of a plot, provided a declaration is obtained from the borrower that he intends to construct a house on the said plot, within such period as may be laid down by the banks themselves.

2.3 The CRE exposures collateralized by eligible credit risk mitigants would be reduced to the extent of risk mitigating effects of the collateral as per the provisions of para 7.3.4 of [Master Circular DBOD.No.BP.BC.21/ 21.06.001/ 2009-10](#) dated July 1, 2009 on Prudential Guidelines on Capital Adequacy and Market Discipline - Implementation of the New Capital Adequacy Framework (NCAF). CRE exposures to the extent secured by Commercial Real Estate would attract a risk weight of 100 per cent. In cases where a part of the CRE exposure is not covered by the security of commercial real estate, that part would attract a risk weight for CRE exposure or as warranted by the external rating of the borrower, whichever is higher.

## **3. Simultaneous classification of CRE into other regulatory categories**

It is possible for an exposure to get classified simultaneously into more than one category, as different classifications are driven by different considerations. In such cases, the exposure would be reckoned for regulatory/ prudential exposure limit, if any, fixed by RBI or by the bank itself, for all the categories to which the exposure is assigned. For the purpose of capital adequacy, the largest of the risk weights

applicable among all the categories would be applicable for the exposure. The rationale for such an approach is that, while at times certain classifications/categorizations could be driven by socio-economic considerations and may be aimed at encouraging flow of credit towards certain activities, these exposures should be subjected to appropriate risk management/prudential/capital adequacy norms so as to address the risk inherent in them. Similarly, if an exposure has sensitivity to more than one risk factor it should be subjected to the risk management framework applicable to all the relevant risk factors.

For instance, in terms of our [Master Circular DBOD. No. Dir. BC 13/13.03.00/2009-10](#) dated July 1, 2009 on Loans & Advances – Statutory and Other Restrictions {para 2.3.7.3 (vi)}, lending in respect of Special Economic Zones (SEZs) has been defined as one of the categories eligible for classification as ‘Infrastructure Lending’. Detailed definition of “Infrastructure Lending” as contained in this circular is reproduced in **Appendix 1**. Since certain types of exposures in respect of SEZs (please see item No. 4 in Part A of **Appendix 2**) would have the characteristics of CRE Exposure as per the approach outlined above, these would simultaneously be classified as both CRE Exposure and “Infrastructure Lending”. In such cases, the risk weight applicable would be that for CRE exposure and not related to borrower’s rating. However, the exposure would be eligible for all the regulatory concessions available to “Infrastructure Lending” as per extant RBI guidelines.

Similarly, an investment in the equity of a real estate company or a Mutual Fund/Venture Capital Fund (VCF) / Private Equity Fund (PEF) which invests in the equity of real estate companies, would be sensitive to the movement in prices of real estate, in addition to having a correlation with the general equity market. Therefore, these would be reckoned both as ‘capital market exposure’ (for the purpose of compliance with the regulatory ceiling fixed by RBI) and the internal ceiling for ‘real estate exposure’ fixed by the bank itself, as required in terms of extant RBI guidelines. At present, such exposures would attract a risk weight of 125 per cent (as applicable to equity exposures) /150 per cent (as applicable to exposure to VCFs), as the case may be, as these risk weights are higher than that applicable to CRE at 100 per cent. The exposure should also be reported to RBI under both the classifications with an appropriate foot note to avoid double counting. Banks could deal with any other instances of dual classification of exposures involving exposure to CRE, based on these principles.

4. In order to assist banks in determining as to whether a particular exposure should be classified as CRE or not, some examples based on the principles described above are given in **Appendix 2**. Based on the above principles and illustrations given in **Appendix 2** banks should be able to determine, whether an exposure not included

in **Appendix 2** is a CRE or not and should record a reasoned note justifying the classification. In case banks have difficulty in making such determination, reference may be made to the Department of Banking Operations and Development with full particulars.

5. These guidelines supercede all previous circulars issued by RBI in so far as these relate to classification of exposures as CRE Exposures. The regulatory instructions governing other aspects of real estate exposure, including those contained in DBS circular dated June 29, 2005, would remain unchanged.

**Definition of 'infrastructure lending'**

Any credit facility in whatever form extended by lenders (i.e. banks, FIs or NBFCs) to an infrastructure facility as specified below falls within the definition of "infrastructure lending". In other words, a credit facility provided to a borrower company engaged in

- developing or
- operating and maintaining, or
- developing, operating and maintaining any infrastructure facility that is a project in any of the following sectors, or any infrastructure facility of a similar nature:
  - i. a road, including toll road, a bridge or a rail system;
  - ii. a highway project including other activities being an integral part of the highway project;
  - iii. a port, airport, inland waterway or inland port;
  - iv. a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;
  - v. telecommunication services whether basic or cellular, including radio paging, domestic satellite service (i.e., a satellite owned and operated by an Indian company for providing telecommunication service), network of trunking, broadband network and internet services;
  - vi. An industrial park or Special Economic Zone;
  - vii. generation or generation and distribution of power;
  - viii. transmission or distribution of power by laying a network of new transmission or distribution lines;
  - ix. construction relating to projects involving agro-processing and supply of inputs to agriculture;
  - x. construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality;
  - xi. construction of educational institutions and hospitals;
  - xii. laying down and/or maintenance of gas, crude oil and petroleum pipelines.
  - xiii. any other infrastructure facility of similar nature.

Illustrative Examples

**A. Exposures which should be classified as CRE.**

**1. Loans extended to builders towards construction of any property which is intended to be sold or given on lease ( e.g. loans extended to builders for housing buildings, hotels, restaurants, gymnasiums, hospitals, condominiums, shopping malls, office blocks, theatres, amusement parks, cold storages, warehouses, educational institutions , industrial parks)**

In such cases, the source of repayment in normal course would be the cash flows generated by the sale/lease rentals of the property. In case of default of the loan, the recovery will also be made from sale of the property if the exposure is secured by these assets as would generally be the case.

**2. Loans for multiple houses intended to be rented out**

The housing loans extended in cases where houses are rented out need to be treated differently. As per Basel II Framework, loans secured by a single or small number of condominium or co-operative residential housing units in a single building or complex also fall within the scope of the residential mortgage category and national supervisors may set limits on the maximum number of housing units per exposure. Therefore, such loans need not necessarily be classified as CRE Exposures. However, if the total number of such units is more than two, the exposure for the third unit onwards may be treated as CRE Exposure as the borrower may be renting these housing units and the rental income would be the primary source of repayment.

**3. Loans for integrated township projects**

Where the CRE is part of a big project which has small non-CRE component, it will be classified as CRE exposure since the primary source of repayment for such exposures would be the sale proceeds of buildings meant for sale.

**4. Exposures towards development of SEZ**

Bank finance for acquisition of land to private developers for setting up of SEZ is not permissible as per extant instructions as stated in para 2.2 of the Annex to this circular. Banks can finance cost of land development, which will be classified as CRE for the reason that the source of repayment would be the lease rentals of the developed plots / sheds.

The following, may however, be noted:

- In cases where there are arrangements to insulate the lease rentals from volatility in the Real Estate prices by way of lease agreements for periods not shorter than that of the loan and there is no clause which allows downward adjustment in the lease rentals, **such cases need not be treated as CRE from the time such conditions get fulfilled.**
- Banks should keep in mind the substance of the transaction rather than the form. For example, it is possible that a SEZ may be developed by a single company entirely or mainly for its own use. In such cases the repayment will depend on the cash flows generated by the economic activities of the units in

the SEZ and the general cash flow of the company rather than the level of real estate prices. **It should not then be classified as CRE.**

- There can be co-developers in an SEZ who undertake a specific job such as provision of sewerage, electrical lines etc. If their repayment are not dependent on the cash flows generated by the CRE asset, **such exposures would not be classified as CRE.** This illustratively would be the case where the co-developer is paid by the main developer based on progress in work.

#### **5. Exposures to real estate companies**

In some cases exposure to real estate companies is not directly linked to the creation or acquisition of CRE, but the repayment would come from the cash flows generated by Commercial Real Estate. Such exposures illustratively could be:

- Corporate loans extended to these companies
- Investments made in the equity/units/debt instruments of these companies
- Extension of guarantees on behalf of these companies
- Derivatives transactions entered into with these companies.

#### **6. Exposures to MFs/VCFs/PEFs investing primarily in the real estate companies**

Exposure to MFs/VCFs/PEFs investing primarily in the real estate companies would be classified as CRE exposure though the exposure would not be directly linked to the creation or acquisition of CRE, because the repayment would come from the cash flows generated by Commercial Real Estate.

#### **7. General purpose loans where repayment is dependent on real estate prices**

Exposures intended to be repaid out of rentals/ sale proceeds generated by the existing CRE owned by the borrower, where the finance may have been extended for a general purpose.

### **B. Exposures which may not be classified as CRE**

**1. Exposures to entrepreneurs for acquiring real estate for the purpose of their carrying on business activities, which would be serviced out of the cash flows generated by those business activities. The exposure could be secured by the real estate where the activity is carried out, as would generally be the case, or could even be unsecured.**

a) Loans extended for construction of a cinema theatre, establishment of an amusement park, hotels and hospitals, cold storages, warehouses, educational institutions, running haircutting saloons and beauty parlours, restaurant, gymnasium etc. to those entrepreneurs who themselves run these ventures would fall in this category. Such loans would generally be secured by these properties.

For instance, in the case of hotels and hospitals, the source of repayment in normal course would be the cash flows generated by the services rendered by the hotel and hospital. In the case of a hotel, the cash flows would be mainly sensitive to the factors influencing the flow of tourism, not directly to the fluctuations in the real estate prices. In the case of a hospital, the cash flows in normal course would be sensitive to the quality of doctors and other diagnostic services provided by the hospital. In these cases, the source of repayment might also depend to some extent upon the real estate prices to the extent the fluctuation in prices influence the room rents, but it will be a minor factor in determining the overall cash flows. In these cases, however, the recovery in case of default, if the exposure is secured by the Commercial Real Estate, would depend upon the sale price of the hotel/hospital as well as upon the maintenance and quality of equipment and furnishings.



The above principle will also be applicable in the cases where the developers / owners of the real estate assets (hotels, hospitals, warehouses, etc.) lease out the assets on revenue sharing or profit sharing arrangement and the repayment of exposure depends upon the cash flows generated by the services rendered, instead of fixed lease rentals.

**b)** Loans extended to entrepreneurs, for setting up industrial units will also fall in this category. In such cases, the repayment would be made from the cash flows generated by the industrial unit from sale of the material produced which would mainly depend upon demand and supply factors. The recovery in case of default may partly depend upon the sale of land and building if secured by these assets. Thus, it may be seen that in these cases the real estate prices do not affect repayment though recovery of the loan could partly be from sale of real estate.

**2. Loans extended to a company for a specific purpose, not linked to a real estate activity, which is engaged in mixed activities including real estate activity.**

A company has two divisions. One division is engaged in real estate activity, and other division is engaged in power production. An infrastructure loan, for setting up of a power plant extended to such a company, to be repaid by the sale of electricity would not be classified as CRE. The exposure may or may not be secured by plant and machinery.

**3. Loans extended against the security of future rent receivables**

A few banks have formulated schemes where the owners of existing real estate such as shopping malls, office premises, etc. have been offered finance to be repaid out of the rentals generated by these properties. Even though such exposures do not result in funding/acquisition of commercial real estate, the repayment might be sensitive to fall in real estate rentals and as such generally such exposures should be classified as CRE. However, if there are certain in built safety conditions which have the effect of delinking the repayments from real estate price volatility like, the lease rental agreement between the lessor and lessee has a lock in period which is not shorter than the tenor of loan and there is no clause which allows a downward revision in the rentals during the period covered by the loan banks can classify such exposures as non CRE. Banks may, however, record a reasoned note in all such cases.

**4. Credit facilities provided to construction companies which work as contractors**

The working capital facilities extended to construction companies working as contractors, rather than builders, will not be treated as CRE exposures because the repayment would depend upon the contractual payments received in accordance with the progress in completion of work.

**5. Financing of acquisition / renovation of self-owned office / company premises**

Such exposures will not be treated as CRE exposures because the repayment will come from company revenues.

**6. Exposures towards acquisition of units / to industrial units in SEZs**

**(a)** Exposures towards acquisition of units in SEZ were specifically included in the definition of CRE vide our circular [DBOD.BP.BC 30/21.01.002/2006-07](#) dated September 20, 2006 in order to prevent speculative dealings in such units. However, since there are restrictions on transfer of such units and require Government permission, the speculative activity in sale and re-sale of units is unlikely to be there.

Therefore, such cases should be more like financing of industrial units or the projects and if such is the case, these would not be treated as CRE Exposures.

**(b)** The exposures to industrial units towards setting up of units or projects and working capital requirement, etc. would not be treated as CRE Exposures.

#### **7. Advances to Housing Finance Companies (HFCs)**

Banks' advances to those HFCs, which are mostly lending to individuals for residential housing as per the norms fixed by National Housing Bank (NHB) and also fulfill the eligibility criteria to draw refinance from NHB, would not be treated as CRE Exposure.