Housing Finance & Regulatory Affairs
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August 22, 2019

Chief Counsel's Office
Office of Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Docket ID OCC-2018-0026
RIN 1557-AE48

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Docket No. R-1669
RIN 7100-AF53

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RIN 3064-AF06
Notice of Proposed Rulemaking:
Regulatory Capital Rules: Treatment of Land Development Loans for the Definition of High Volatility Commercial Real Estate (HVCRE) Exposures

Dear Sir or Madam:

The National Association of Home Builders (NAHB) appreciates the opportunity to submit comments on the above referenced Notice of Proposed Rulemaking (current NPR) regarding the treatment of loans that finance land development for one-to-four family residential properties and when these loans may qualify for exclusion from the revised definition of High Volatility Commercial Real Estate (HVCRE).

Understanding how to apply HVCRE capital requirements to acquisition, development and construction (ADC) financings has generated confusion since the risk-based capital requirements to implement Basel III became effective for all banking institutions in January 2015. The confusion has caused the Office of Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC) (collectively, "the banking agencies") to issue numerous HVCRE clarifications via FAQs and proposed rules. We look forward to responding to this NPR with the hope that a final

rule can be issued this year that will clearly define HVCRE requirements, including when exclusions apply. NAHB believes this will expand lending to home builders and developers to support their efforts to increase the supply of homes throughout the country.

NAHB is a Washington DC-based trade association representing more than 140,000 members involved in the development and construction of for-sale single family homes, including homes for first-time and low- and moderate-income homebuyers, as well as the construction, ownership and management of multifamily rental housing, including affordable rental housing. NAHB's members are predominately small to mid-sized home builders and developers who rely on their community banks as their primary source of ADC financing. Easing the regulatory burden faced by community banks has the potential to improve the ability of NAHB's members to address housing needs in their communities and contribute to economic growth.

Housing Market Conditions

Safe, decent, affordable housing provides fundamental benefits that are essential to the well-being of families, communities and the nation. Yet owning or renting a suitable home increasingly is out of financial reach for many households. In fact, almost a third of the nation's households are cost burdened and pay more than 30 percent of their income for housing. The cost of housing is determined by a complex equation involving labor and materials prices; interest rates and financing costs; federal, state and local regulations; and supply and demand. In today's market, a limited supply of land, a shortage of skilled labor, and rising fees all are contributing to higher house prices. NAHB analysis shows that regulatory requirements alone account for 24 percent of the cost of constructing a single-family home, and 32 percent of the cost of a multifamily unit. These factors make it difficult to increase the supply of affordable housing and to ensure that it meets the needs of increasingly diverse households.

Integral to meeting the supply of homes at all economic levels and in all geographic markets is the cost and availability of land for single family development. The current availability of readily buildable lots is at a crisis-level low, pushing up the cost of those lots and ultimately the price of the homes built on them.

NAHB surveys its members on lot availability annually. In the most recent survey, 65 percent of builders reported that the overall supply of developed lots in their areas was *low to very low.* Sixty-five percent is the largest low supply percentage recorded since NAHB began asking the question periodically in 1997. The 65 percent includes 43 percent who characterized the supply of lots simply as *low* and 22 percent who said the supply of lots was *very low*. The lot supply problem is particularly severe in relation to housing starts, which still have only partially recovered from the last downturn. After averaging 1.5 million from 1960-2007 and hitting a peak of 2.0 million in 2005, starts have recovered only to about 1.2 million per year. The continued low supply of developed lots is a hindrance to a more robust housing recovery, and helps explain some of the recent weakness in new home sales[1].

The ability to develop buildable lots starts with the availability of financing on terms that can make the project feasible. In the second quarter of 2019, interest rates on loans for land acquisition, development, and single family construction continued to drift upward, according to results from NAHB's quarterly ADC financing survey[2]. As the survey showed, the highest average interest rate—6.59 percent—was recorded on loans for land

[1] Problems with Lot Availability Remain Widespread, NAHB Blog, Ashok Chaluvadi, November 5, 2018.
[2] Survey on Acquisition, Development and Construction Financing, Second Quarter 2019, Pages 4-5

acquisition, followed by 6.49 percent on loans for land development, 6.21 percent on loans for speculative single family construction, and 5.97 percent on loans for pre-sold single family construction. The upward trend in interest rates on ADC loans in 2019 occurred while the Federal Reserve's target federal funds rate remained stable and mortgage rates were generally trending downward.

For land development loans, 72 percent of respondents listed commercial banks as the primary source of credit[3]. Therefore, the capital treatment of land development loans by commercial banks can have a significant impact on the cost and availability of these loans to developers.

Background on Implementation of HVCRE Capital Requirements

In June 2012, the banking agencies issued a proposed rule to apply Basel III international regulatory capital standards to U.S. banks. The proposed rule recommended risk-based capital requirements for a newly created classification of commercial real estate loans called High Volatility Commercial Real Estate. The banking agencies proposed a risk-weight of 150 percent for ADC loans meeting the HVCRE classification versus a 100 percent risk-weight for ADC loans not classified as HVCRE. In response to the proposal, NAHB expressed concerns that the HVCRE requirements for ADC financing would have unnecessary negative consequences for community banks and their home builder and developer customers. This was of concern to NAHB because NAHB's members, as noted above, rely on community banks for their ADC financing.

From the beginning, financial institutions found the definition of HVCRE loans hard to understand. The confusion appeared to cause banks to apply the HVCRE classification unevenly, often erring on the side of caution and classifying all commercial and multifamily ADC loans as HVCRE and charging increased fees to cover the cost of holding the additional capital or pulling back from ADC commercial and multifamily real estate lending. From NAHB's perspective, both reactions have had a negative impact on lending to home builders and developers.

Attempts to clarify the loans that should be classified as HVCRE for purposes of the increased risk-weight have been made since 2015 when in March the banking agencies issued answers to Frequently Asked Questions regarding the capital rule. While helpful, many in the industry continued to press for additional guidance.

In March 2017, the banking agencies submitted a report to Congress pursuant to their review of the capital rule under the *Economic Growth and Regulatory Paperwork Reduction Act of 1996*. In the report, the banking agencies acknowledged the capital rule to be unduly complex and burdensome and announced their intent to meaningfully reduce the regulatory burden on banks, in particular, the burden on community banking organizations. The findings of the banking agencies resulted in an NPR issued in October 2017 that included significant revisions to the then-current definition and capital treatment of HVCRE loans. The agencies hoped *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (2017 Simplifications Proposal)* would address the questions and ambiguity that surrounded these loans. While NAHB believed the 2017 proposed rule offered some constructive improvements to the flawed HVCRE requirements, our comments highlighted a number of drawbacks for financial institutions.

Not until Section 214 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* of 2018 (EGRRCPA), which amended the Federal Deposit Insurance Act by becoming a new section of the Act, was

[3] Survey on Acquisition, Development and Construction Financing, Second Quarter 2019, Page 14

significant progress achieved. The statute very clearly defined an HVCRE ADC loan and the exemptions from the HVCRE classification. When the banking agencies issued a proposed rule in September 2018, *Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures* (September 2018 HVCRE NPR) with regulations to implement the statute, NAHB's comments were positive.

The current NPR proposing specific requirements for the treatment of land development loans for one-to-four family residential properties raises concerns.

NAHB Comments

The current NPR proposes that land development loans that do not include financing for construction of one-to-four family residential structures would be classified as HVCRE loans and require financial institutions making the loans to hold capital at the risk-weight of 150 percent.

NAHB strongly recommends that land development loans for one-to-four family residential properties be exempt from the HVCRE ADC classification even when the loan does not include financing for the construction of the one-to-four family residential structures.

NAHB believes land development loans for properties on which one-to-four family residential structures will be built are clearly exempt from HVCRE classification under EGRRCPA's statutory definition of HVCRE CRE loans regardless of whether the construction financing is included.

The statute states that an HVCRE loan will only be subject to increased risk-weight for capital purposes if it is an HVCRE ADC loan which is defined as a credit facility secured by land or improved real property that, prior to being reclassified by the depository institution as a non-HVCRE ADC loan, meets ***all*** the following:

(a) primarily finances, has financed, or refinances the acquisition, development, or construction of real property;
(b) has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and,
(c) is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility.[4]

As per this statutory definition, a land development loan for the purposes of developing land for one-to-four family residential properties is exempt from HVCRE because it does not meet (b) as described above.

The statute also stipulates that an HVCRE ADC loan ***does not include*** a credit facility financing the acquisition, development, or construction of properties that are one-to-four family residential properties. This provision further clarifies that loans solely for purposes of developing land for one-to-four family residential structures are intended to be exempt from HVCRE classification and a subsequent risk-weight of 150 percent.

NAHB submits that by not following the clear provisions of the statute, the federal banking agencies risk adding to the confusion, rather than clarifying when HVCRE loans must be classified as HVCRE ADC loans for risk-weighting purposes.

[4] ''Economic Growth, Regulatory Relief, and Consumer Protection Act,'' Page 26

Though this current NPR strictly pertains to land development loans, NAHB is taking this opportunity to note that the same line of reasoning should be applied to land acquisition loans. In the September 2018 HVCRE NPR, the federal banking agencies proposed that loans used solely to acquire undeveloped land would not fall within the scope of the one-to-four family residential properties exclusion regardless of how the land is zoned. In our response, NAHB opposed classifying a loan to acquire undeveloped land as an HVCRE ADC loan. We want to restate our position that loans that solely finance land acquisition for one-to-four family residential properties should not be considered HVCRE financings for the same statutory reasons we are now opposing the proposal that loans that solely finance land development of one-to-four family residential properties should not be considered HVCRE financings.

NAHB respectfully notes that the agencies have added another layer of confusion by stating in the current NPR that loans made solely to finance land development for one-to-four family residential properties could be subject to a lower risk-weighting if the loan qualifies for an exclusion other than the one-to-four family residential property exemption. However, the other applicable exclusions included in the statute are real property that would qualify as an investment in community development, agricultural land or some commercial real property projects. Since land development loans for one-to-four family properties would not meet those definitions, they would be generally subject to a higher risk-weight making them more expensive and less available.

Impact to Home Builders

NAHB is concerned with the proposed rule's variance from the statute because of the potential negative impact on NAHB's builder/developer members as the cost and availability of financing has a direct impact on the supply and affordability of housing.

As noted earlier, obtaining financing for the acquisition and development of lots for one-to-four family homes is a challenge for many of NAHB's home builder and developer members. Sixty-one percent of NAHB's builder members are single-family builders and four percent are land developers. An even bigger challenge for many is finding developed lots for building one-to-four family homes because there are not enough lots being developed. Today many small, residential home builders want to purchase developed lots and rely on land development by independent developers for buildable lots.

While land developers may also build homes, they generally do not obtain the construction financing under the same entity with a combination land development/construction loan. Industry practice has separate entities developing lots that are sold to either a related or unrelated home building entity that constructs the homes. Therefore, under the terms of the current NPR, most land development loans would be classified as HVCRE and require banks to risk-weight the loans at 150 percent. Even if a developer has a signed contract with a builder who has agreed to purchase the developed lot(s) and has provided a sufficient deposit, the developer would still not be able to obtain a land development loan that is exempt from HVCRE classification.

An increased capital charge of 150 percent for land development loans likely will increase the rate and/or fees charged by a bank, or more likely reduce the amount of bank financing available for land development. In a paper released by the Federal Reserve Board in August 2018, the authors report on the effect of a 50 percent

increase in the amount of capital required to fund HVCRE loans. Their research determined that the HVCRE rule increased the interest rate on loans treated as HVCRE by an estimated 40 basis points.[5]

Increased costs of land development loans for one-to-four residential properties will translate directly to higher prices for homes.

NAHB believes land development loans and land acquisition loans should be exempt from HVCRE classification when the land is being acquired or developed for one-to-four family residential structures without being combined with the construction loan.

Exempting land development loans and land acquisition loans from HVCRE classification when land is being acquired or developed for one-to-four family residential structures will provide a lower-cost option for land developers and potentially increase the availability of developed lots for builders. Because of the importance of banks as a source of capital for developers and builders, NAHB believes this would be positive for the supply of affordable housing.

Actions by the Administration and Congress

Request from Congress to the Banking Agencies

The Economic Growth, Regulatory Reform and Consumer Protection Act (EGRRCPA or S. 2155) was passed with the intent to reduce the regulatory burdens for financial institutions to expand access to capital. A report issued by the White House Council of Economic Advisors states that EGRRCPA "is expected to reduce regulatory burdens and help to expand the credit made available to small businesses that are the lifeblood of local communities across the nation." The report further states that it is estimated EGRRCPA "has annual net benefits of almost $5 billion and raises real annual incomes by about $6 billion by removing regulatory burdens from small bank lenders."

In a letter dated July 30, 2019 to the Honorable Jerome H. Powell, Chairman, Federal Reserve, Honorable Joseph M. Otting, Comptroller of the Currency, OCC, and Honorable Jelena McWilliams, Chairman, FDIC, the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Senate Banking Committee) urged the banking agencies to continue to support initiatives to expand on EGRRCPA and the Tax Cuts and Jobs Act of 2017 to support economic expansion.

NAHB proposes that eliminating (rather than increasing) the compliance and cost burdens of HVCRE on community banks and other financial institutions would be consistent with the intent of EGRRCPA and the recent request to the banking agencies by members of the Senate Banking Committee.

Executive Order from President Trump

On June 25, 2019, President Trump signed Executive Order 13878, "Establishing a White House Council on Eliminating Regulatory Barriers to Affordable Housing." The president emphasizes that a multitude of regulatory

[5] Glancy, David and Kurtzman, Robert J., How Do Capital Requirements Affect Loan Rates? Evidence From High Volatility Commercial Real Estate (August 21, 2018). Available at SSRN: https://ssrn.com/abstract=3202509 or http://dx.doi.org/10.2139/ssrn.3202509

barriers by Federal, State, local, and tribal governments hinder the development of housing. Though regulatory barriers experienced by financial institutions are not specifically mentioned, the purpose of the president's action is to highlight the impact that regulatory barriers have on the cost of housing development and are contributing to the lack of adequate supply of affordable housing.

The president has directed the newly-established Council to reach out to State, local and tribal government officials, as well as relevant private-sector stakeholders, including developers and home builders, to solicit feedback to identify Federal, State, local and tribal laws, regulations, and administrative practices that artificially raise the costs of housing development and contribute to shortages in housing supply. Further, the Council will identify practices and strategies that most successfully reduce and remove the laws, regulations, and administrative practices that are identified as problematic.

NAHB is using this opportunity to raise concerns about banking regulations that make it harder for home builders and developers to access affordable ADC financing and emphasize that increasing costs and access to affordable land acquisition and development financing will continue to impede the industry's ability to increase the supply of housing, including affordable housing.

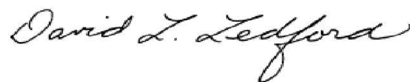
Conclusion

NAHB believes the current NPR should be withdrawn. It deviates from the statute in a way that is inconsistent with the intent to clarify HVCRE rules and resolve issues NAHB believes have discouraged lending to developers and home builders for more than four years. It goes against industry practices and would not reduce the compliance burden on banks as required by EGRRCPA and President Trump's Executive Order.

If the current NPR is finalized as proposed, community banks that are constrained by the higher capital costs of land development loans on one-to-four family residential properties could reduce the availability or increase the cost of ADC financing. Both potential impacts would exacerbate the already low availability of affordable ADC financing to the housing industry that has contributed to the low housing supply across the country and increased housing costs to consumers.

Please contact Becky Froass, Director, Financial Institutions and Capital Markets, at rfroass@nahb.org 202-266-8529 if you have any questions about our comments on this issue.

Sincerely,



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