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**RE: Credit Risk Retention — OCC (Docket No. OCC-011-0002, RIN 1557-AD40), Federal Reserve System (Docket No. R-1411, RIN 7100-AD-70), FDIC (RIN 3064-AD74), FHFA (RIN 2590-AA43), SEC (File No. S7-14-11, RIN 3235-AK96), HUD (Docket No. FR-5504-P-01, RIN 2501-AD53)**

Dear Ladies and Gentlemen:

On behalf of the multifamily industry, the National Multi Housing Council and National Apartment Association (NMHC/NAA) are pleased to comment on the proposed rule on credit risk retention. This proposed rule implements the requirements set forth in Section 15G of the Securities Exchange Act of 1934 (15 U.S.C § 78o-11), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act, P.L. 111-203). This section establishes the requirement that a securities issuer of asset-backed securities retain not less than five percent of the credit risk of the assets serving as collateral, including mortgage instruments. Our comments are specific to the regulations associated with commercial mortgage-backed securities (CMBS) and the proposed exemption that would not require risk retention under certain conditions.

NMHC and NAA represent the nation's leading apartment firms. Our combined memberships are engaged in all aspects of the industry, including ownership, development, management and finance. NMHC represents the principal officers of the industry's largest and most prominent firms. NAA is the largest national federation of state and local apartment associations, with 170 state and local affiliates comprised of more than 50,000 members. Together we represent approximately six million apartment homes.

NMHC/NAA commend the Agencies for their efforts to create a framework to bring transparency and investor confidence back to the CMBS market.<sup>1</sup> We appreciate the need to establish a balance that on one hand aligns the interests of both securities issuers and the investor market and, on the other hand, fosters a market that meets the needs of an extensive range of institutional investors by providing effective mortgage products for multifamily and commercial real estate borrowers and investors.

NMHC/NAA members and the multifamily sector in general rely upon a variety of credit capital sources, all of which are regulated. These include whole loan mortgage products offered by banks, insurance companies, pension funds and other private credit sources; credit facilities and credit enhancement of taxable and tax-exempt bonds through these sources and from the secondary multifamily mortgage programs of the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac; mortgage insurance through the Federal Housing Administration, often securitized by the Government National Mortgage Association (Ginnie Mae); and credit from state housing finance agencies (HFAs).

The CMBS market is a critical source of mortgage liquidity, and NMHC/NAA are committed to efforts by the financial industry and regulators to create a more stable and reliable market for the multifamily industry. To ensure the CMBS market functions as intended to provide the financing that allows our industry to house millions of American families, the regulations must align the interests of investors, issuers, originators, servicers and borrowers. To that end, they should create prudent mortgage lending and underwriting practices that serve to restore investor confidence by enabling the collateral risk and structure of mortgage securities to be easily assessed. Additionally, and of equal importance, for the borrower to participate in the CMBS market, the management and servicing of the underlying mortgage debt, including the mitigation and resolution of troubled mortgages, must also reflect the alignment of interest of the investor and the borrower. Without an alignment between asset management and mortgage servicing, higher-quality deals will seek alternative financing, and the underlying mortgages in CMBS will continue to include poor quality properties, weaker than average sponsors and a continued concentration of mortgage assets that are located in higher-than-average risk markets.

#### **Specific Comments on the Proposed Rule**

NMHC/NAA offer the following comments and recommendations, from the perspective of the borrower and investor, for your consideration. Our goal is not only to ensure that the cost of mortgages remains as low as possible, but also to foster an environment characterized by liquidity and consistency. The mortgage financing of multifamily real estate is not solely about securing debt for a standardized commodity. Indeed, by virtue of the duration of the mortgage loan, it must reflect the long-term relationship between lender and borrower. The vehicle of investor capital to provide the debt must be structured for market interests, but it must also be provided for what it is; namely, a package of loans secured by the income stream from leases to families and businesses.

##### **I. Risk Retention Structure**

The Dodd-Frank Act establishes a variety of ways in which issuers (and others) can retain risk in mortgage securities to ensure that parties to the transaction share an alignment of interest in the areas of origination, securities issuance and servicing. In the interest of promoting efficiency while ensuring the underlying goal of risk retention is met, NMHC/NAA support providing such a menu of options. It is a fact that the method by which an issuer retains risk is not the domain of the borrower or any one sector of the commercial real estate market. Rather, it is important from a perspective of transparency and understanding of the ultimate cost of the transaction to the borrower. As an end user of CMBS debt capital, the multifamily industry supports a regulation that provides flexibility and options that can be used to provide mortgage financing tailored to meet the need of the property, market, borrower and other investors in a given project.

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<sup>1</sup> The proposed rule implements the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934, as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rule was jointly issued for comment by the Office of the Comptroller of the Currency, Treasury (OCC), Board of Governors of the Federal Reserve System (Federal Reserve Board), Federal Deposit Insurance Corporation (FDIC), U.S. Securities and Exchange Commission (Commission), Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development (HUD), collectively referred to as the "Agencies."

NMHC/NAA support risk retention provisions that provide for risk to be shared *pari passu* or through other loss-sharing structures among the mortgage seller (loan originator) and the securities issuer, as well as the subordinated unrated investor. The mortgage pools that form the security interest for the CMBS are relatively static and, therefore, are well positioned for such loss-sharing structures.

NMHC/NAA also would encourage regulators to explore the retained risk provisions that have been effectively used as part of the Fannie Mae Multifamily Delegated Underwriting and Servicing program. These provisions, as well as those of the Freddie Mac Program Plus and Multifamily K Certificate, have been used as part of the GSEs' securitization efforts to provide liquidity to the multifamily industry. Importantly, these long-term programs have operated with limited credit-related problems and have operated in all markets at all times. Their securities are widely accepted and are purchased by investors of all types.

The investors who purchase these securities do so because they are backed by the government but also because they feature a strong performance record. With less than 300 mortgage defaults over a 20-year period, there is strong investor certainty that they will receive the full benefit of return over the investment period. While any program is not without flaws, the two programs have helped bring debt capital to the market and provided financing within a structured framework that has been widely accepted by the investor market. The originator is assigned servicing of the mortgage and, as such, the relationship between the borrower and lender is established and endures throughout the term of the mortgage. NMHC/NAA encourage regulators to evaluate whether the delegation model could work but would recommend it be pursued not solely from an origination perspective, but also from a servicing perspective.

## **II. Qualified Mortgages and Exemption from Risk Retention**

The Dodd-Frank Act requires the Agencies to establish underwriting standards for low-risk loans that, if met, would not be subject to risk retention requirements. In our view, under the proposed rule, only loans that exceed the requirements for many loans considered to be of investment grade by institutional credit providers or that would typically be included as collateral for commercial mortgage securities would qualify for an exemption. Accordingly, exemption from risk retention appears to be the exception, not the rule.

The goal of establishing a qualified mortgage for purposes of providing an exemption from risk retention requirements, as understood by the multifamily industry, is to find the exception that would have minimal or limited impact on the performance of a CMBS loan pool. However, as mentioned above, we believe that under the criteria established by the proposed rule, few loans will meet the requirements. Based on our understanding of the proposed rule, the regulators perceive a five percent issuer-held position in the transaction to be a better hedge against loan failure than income properties with strong, reliable and durable revenue streams; well-documented borrower requirements and covenants; and prudent representations and warranties by the originator and issuer. We question this wisdom, as it may not achieve the goal of improving the overall quality of the loans, but may rely too heavily upon retained risk by the issuer and parties to the origination and issuance of the CMBS.

NMHC/NAA would encourage regulators to take a broader approach to determining whether a mortgage should qualify for an exemption from the risk retention rules. In particular, we recommend allowing a greater percentage of commercial real estate-based mortgages (e.g., those for apartments, office buildings, retail, hotels, industrial and storage) to qualify. This approach would rely upon the quality of the underlying real estate and draw borrowers to the credit, as opposed to attracting lower-quality real estate and sponsors and relying upon retained risk to improve documentation, credit underwriting and origination.

To further illustrate this point, according to an April 2011 analysis performed by Morgan Stanley, less than one percent of loans would qualify for the proposed qualified mortgage criteria.<sup>2</sup> Such criteria could have a

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<sup>2</sup> North America CMBS Strategy, Morgan Stanley Research, CMBS Market Insights: The Dodd-Frank NPR: Implications for CMBS, April 12, 2011.

negative impact on the ability of issuers to aggregate multifamily mortgage assets. NMHC/NAA, therefore, consider the intent of the proposed rule is to raise capital and require a risk position—not attract quality multifamily mortgages, assets and borrowers. As a result, while the proposed rule is, in part, intended to change how loans are underwritten, we are not confident that the underwriting will materially change and that the overall loan quality will improve.

We would suggest the Agencies consider the performance of multifamily mortgage loans issued by the insurance industry, GSEs and even commercial banks to determine an appropriate underwriting standard for CMBS multifamily loans. In our view, as proposed in the rule, a minimum 1.70x debt service coverage ratio, 65 percent loan-to-value (LTV) maximum and an amortization period of 20 years or less is not a "reasonable" set of criteria for mortgage loans.

NMHC/NAA would respectfully request that loan performance with a break-even occupancy of 80 percent, using a minimum debt yield of 10-12 percent (due to interest rate volatility), an LTV of 70-75 percent based on full appraisal and a debt coverage ratio of 1.35x based on historical in-place income would significantly reduce the risk of monetary loan default by the borrower and protect against local market risk. This level of debt coverage is more conservative and well above GSE (Fannie Mae and Freddie Mac) multifamily mortgage loan requirements at origination, and those programs have a serious delinquency rate (60 days or more) of less than one percent.

We also recommend that there should be a direct relationship between LTV and amortization, allowing low-LTV loans (at or below 65 percent) to have 30-year amortization periods, since the default and refinance risk on many interest-only and low-LTV loans is limited given the borrower's strong equity stake in the property.

Finally, NMHC/NAA strongly request that real estate investment trusts (REITs) not be excluded from the definition of a borrower that would be included for qualified mortgages. Multifamily REITs are considered very strong financial and creditworthy borrowers. They have strong institutional asset management, provide great transparency regarding operating and income information and have some of the best performance records among borrower types.

### **III. Risk Retention Period**

The Dodd-Frank Act directed the Agencies to consider a period of risk retention that would be shorter than the term of the securities. Section IV D of the regulation, dealing with section 15(g)(a)(1)(A) of the Dodd-Frank Act regarding the hedging, transfer or financing restrictions, proposes that a sponsor (or consolidated affiliate) would be prohibited from transferring the retained interest or the assets until such time as the retained interest or the assets were fully repaid or extinguished.

The proposed rule seeks input (questions 102(a) and 102(b)) on the appropriateness to transfer or hedge retained exposure after a specified period of time. As such, we recommend that the Agencies determine the minimum holding period necessary to prevent the cost of risk retention from having a material impact on price. The goal is to attract adequate investor capital at a reasonable price based on the information disclosed to investors. In our view, the amount and term of the risk retained by the issuer, originator and first-loss investor (i.e., the so-called B-piece buyer) provide the CMBS investor with the necessary information to make a qualified investment decision.

NMHC/NAA support a shorter retained risk period than that of the maturity of the securities by issuers and originators to improve the overall pricing of mortgage loans and securities. We recommend that if a loan meets the rating agencies' review, and the mortgages perform as underwritten, the retained risk position should be reduced after three to five years, depending on the term of the securities. We feel it is important to strike a balance between added cost of risk-based capital to the transaction and the overall cost of the transaction.

**IV. Subordinated Investors and Risk Retention**

The Dodd-Frank Act provides that the subordinated investor (i.e., the B-piece buyer) can meet the requirements of risk retention in a CMBS issuance. It is our understanding, however, that the proposed rule creates disincentives that could reduce the participation of B-piece buyers.

Specifically, the proposed rule would create conflicts between the B-piece buyer and the operating advisor and affiliated or non-affiliated special servicers. While these conflicts could advantage other investors and, in some cases, the holders of mortgage assets (the borrower), these conflicts could create disincentives. If, for example, the B-piece buyer, who is in the first-loss position, is unable to resolve troubled assets through the affiliated special servicer or is forced to make concessions to meet the needs of other investors whose loss positions are subordinated to theirs, their incentives for investment are not as strong. This disincentive may impact the overall cost of a transaction by increasing the risk to the B-piece buyer.

The multifamily industry supports the use of an operating advisor to enhance the decision-making process to resolve issues with troubled mortgage assets within a CMBS pool to ensure that all investor interests are addressed. We also support greater disclosure about the options for mortgage modifications and workouts.

**V. Special Servicing and Operating Advisors**

One of the unique features of the subordinated investor is the affiliated relationship with the special loan servicer. Mortgage borrowers have found the existing servicing requirements problematic due to the misalignment of interests between classes of investors and the mortgage borrower. Although it is critical that the rights of investors be respected, borrowers have, on too many occasions, lost control over their property when a temporary modification or other resolution could have prevented default.

NMHC/NAA support the inclusion of a third-party servicing advisor to ensure all interests are met. However, we want to ensure that the role and activities of such an advisor support special servicing activities and do not prevent subordinated investors from participating in CMBS transactions, significantly increase the cost of the mortgage debt or materially restrict the loan terms and requirements to secure a conduit mortgage loan.

**VI. Premium Capital Capture Reserve Account**

The proposed rule's Premium Capital Capture Reserve Account (PCCRA) was not required by the Dodd-Frank Act. As proposed, if a sponsor structures a securitization to monetize the excess spread on the mortgage assets in the CMBS pool—which typically takes place through the sale of an interest-only tranche in the CMBS or the sale of premium bonds—the proceeds from the sale of the tranche or bonds would be placed in an account held in reserve against losses.

This reserve fund would be in addition to retained risk capital held by issuers and affiliated parties. In the past, CMBS issuers have used interest-only strip to generate revenue to cover overhead, hedge costs and create additional profit. We are not commenting on the PCCRA's intent to limit profits or create additional collateral through an additional first-loss position.

We note, however, that if firms are denied the ability to continue this, we are concerned that worst case it will create such significant disincentives that companies may exit the CMBS market entirely.

Alternatively, they may increase their costs, which would be passed on to borrowers, to cover the loss of these revenues. This added cost is likely to be reflected as a premium on the mortgage interest rate or mortgage fee, much like an issuance fee in a taxable or tax-exempt bond execution that is secured by a multifamily mortgage.

NMHC/NAA support an active and liquid commercial mortgage-backed securities market and hope the recommendations offered above will provide an even stronger alignment of interest among all parties, borrowers, originators, issuers and investors. We look forward to working with the Agencies in this critical rulemaking effort.

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Should you require further information or have any questions, please do not hesitate to contact David Cardwell, Vice President of Capital Markets and Technology for the NMHC/NAA Joint Legislative Program, at (202) 974-2336 or [dcardwell@nmhc.org](mailto:dcardwell@nmhc.org).

Sincerely yours,



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