



October 30, 2017

Board of Governors of the Federal Reserve System
Attn: Ms. Ann E. Misback, Secretary
20th Street & Constitution Ave., NW
Washington, DC 20551

RE: Docket No. OP – 1573: Request for Information Relating to Production of Rates

To Whom It May Concern:

The CRE Finance Council (CREFC) appreciates this opportunity to comment on the Board of Governors' (Board) proposed production and publication of three benchmark rates based on overnight Treasury repos (a "Repo-Based Rate").¹ CREFC commends the Board's efforts to develop voluntary benchmark tools for the market, particularly in light of the London Interbank Offered Rate (LIBOR) termination at the end of 2021. Commercial real estate (CRE) and multifamily finance participants currently are facing significant uncertainty with respect to potential LIBOR replacement rates and are in search of solutions for both LIBOR legacy loans and those loans that are being originated today and go forward, each with terms that will extend beyond the termination of LIBOR.

We understand that the Board has not explicitly framed its proposed rates as LIBOR replacements. Yet, without any viable alternatives currently in the marketplace, this Board project represents the best strategy for a successful transition to a post-LIBOR environment. An alternative floating-rate benchmark is vital to properly functioning commercial and multifamily finance floating-rate markets here in the U.S.

When engineering that new Repo-Based Rate and potential LIBOR-replacement, we do have questions regarding the rates' applicability and utility in the CRE context that we would like you to consider. Below, we highlight some of those issues and provide general recommendations regarding features a LIBOR replacement regime should include to be most helpful to our industry.

¹ Federal Reserve System, Request for Information Relating to Production of Rates, Docket No. OP-1573, 82 Fed. Reg. 41259 (Aug. 30, 2017).

By way of background, CREFC is the trade association for the \$3.9 trillion commercial real estate finance industry. More than 300 companies and 9,000 individuals are members of CREFC. Member firms include balance sheet and securitized lenders, loan and bond investors, private equity firms, servicers and rating agencies, among others. Our industry plays a critical role in the financing of office buildings, industrial and warehouse properties, multifamily housing, retail facilities, hotels, and other types of CRE that help form the backbone of the American economy.

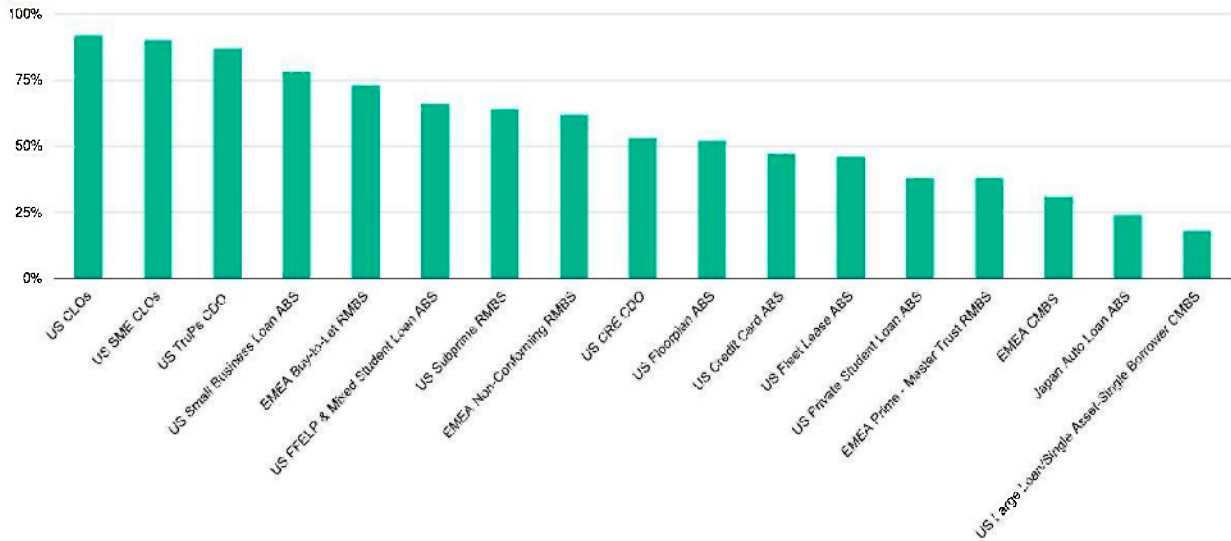
CREFC promotes liquidity, transparency and efficiency in the CRE finance markets. It does this by acting as a legislative and regulatory advocate for the industry, playing a vital role in setting market standards and best practices, and providing education for market participants.

The transition from the LIBOR benchmark will greatly affect the industry given its reliance on LIBOR as a benchmark for floating-rate loans often secured by transitional CRE and multifamily assets. Several securitization sectors have significant links to LIBOR and floating-rate exposure, including balance sheet loans originated by banks, insurance companies, REITs, private funds, and other lenders, as well as loans backing commercial mortgage-backed securities (CMBS) and corporate debt obligations (CDOs). Each side of the business, balance sheet and securitized loans, represent tens of billions of dollars in exposure, with hedge facilities attached to most.

To illustrate, the chart below shows, for select asset classes, the share of tranches rated by Moody's that are tied to LIBOR.

Links to LIBOR are Common in Many Structured Finance Sectors

(from report published on 09/13/2017)



Source: Moody's Investors Service

The sunsetting of LIBOR will affect a number of contracts within the CRE/multifamily finance sector, including:

- Loan agreements, pooling and servicing agreements, trust agreements, and indentures pursuant to which floating-rate commercial mortgage backed securities (CMBS) and/or CRE collateralized loan obligations (CLOs) are issued;
- Interest-rate cap agreements entered into in connection with whole CRE loans and other swaps and derivatives,
- Disclosure documents (i.e., prospectuses and offering circulars).

What follows is a brief discussion of CREFC's main concerns and principles with respect to any LIBOR replacement rate structure.

1. Publication of replacement rates as soon as possible

To the extent the Board does endeavor to produce LIBOR replacement rates for use by the market, CREFC supports publication of those rates as soon as possible for a number of reasons:

- **Risk of Earlier Than Expected LIBOR Sunset.** CREFC has some concern that LIBOR rates may cease to be published before the scheduled phase-out at year-end 2021 because of potential litigation risk surrounding inadequate transaction volume to support LIBOR

reporting by the remaining panel banks. Publication of other benchmark rates in the near future would minimize the risk that LIBOR ceases to be quoted before a replacement index is identified.

- **Sufficient Time to Understand Correlation between LIBOR and Replacement Index.** Markets will need a sufficiently lengthy period of overlap between LIBOR's sunset and any replacement rates in order to study and understand the relationship or correlation (or lack thereof) between the benchmarks. Without any history with replacement rates in relation to LIBOR, the industry will not know if new rate levels are comparable to LIBOR rates, if volatility patterns resemble LIBOR's, if there are impacts on cross-border financial activities as other jurisdictions also transition to new rates, etc. Once there is some understanding of these dynamics, the market will need time to transition documentation and pricing to any new benchmark(s) and develop a spread methodology (if needed) that minimizes impact on valuations, transaction volumes, and hedging activities.
- **Speedy Publication of Rates.** Publishing rates on an alternate LIBOR index as soon as possible will provide much-needed certainty to the market. In the absence of viable replacement rates, LIBOR legacy loans will continue to be written without standardized replacement rate language—only compounding complexity and industry burdens and, more importantly, the risk of market dislocation that could occur as a result of any transition from LIBOR rates. Several CREFC members have expressed concerns about increased liability and litigation risk during this transition period (as loans are adjusted from LIBOR), particularly in the absence of any identifiable, workable LIBOR alternative.

2. Mechanism for extrapolating term rates from spot benchmark rates

The CRE sector largely operates on a term-rate basis. Accordingly, if an overnight benchmark rate were produced and utilized by the market, we would need some standardized, widely available mechanism—provided through a government body or the private market—to extrapolate term rates from the spot rate to make the benchmark useable in our space. We understand that the Chicago Mercantile Exchange (CME) is working to develop standardized futures contracts for use by the market, a project CREFC strongly supports. While CREFC largely supports private-sector solutions to issues across the capital markets, we believe the Board should explore whether it can provide a universally acceptable mechanism to transform spot rates to term rates. While private solutions, including the work by the CME may succeed, we think it important that the Board explore the possibility of its own solution. Such a Federal Reserve System solution would eliminate entirely issues surrounding the potential of a multiplicity of private and conflicting solutions.

The 30-day term is the most commonly used by our members (as a reset frequency in loans and reset term in hedging facilities), but various parts of the sector do utilize other terms for which LIBOR publishes rates (e.g., one month, three months, one-year). To minimize potential market disruptions and ease transition burdens, we therefore think it is important for replacement rates to exist for all of the current LIBOR points.

3. Tools to account for adjustment challenges between LIBOR framework and any new benchmark regime

In addition to CREFC's concern as to what will replace LIBOR, the industry is focused on how it will adjust (if at all) its business models (e.g., pricing, documentation, hedging activities, etc.) to a new benchmark structure. As noted above, a sufficient transition period will be essential to assess and respond to inevitable differences between regimes.

With respect to the Board's proposed Treasury repo rates, for instance, notable differences between those rates and LIBOR—for which the market presumably would have to account in adjusting pricing, etc.—include:

- An overnight rate versus a term structure, and whether the former can reliably and transparently be converted to the latter;
- Differences in overall volatility between overnight rates and 30-day and other relevant term rates;
- Risk-free rates versus rates that reflect the actual borrowing costs of transactions with credit/counterparty risk;
- Secured rates versus unsecured rates; and
- A standardized international approach to benchmark rates (i.e., the IBORs) versus a U.S.-based rate.

Taken together, the International Swaps and Derivatives Association's (ISDA) work for its constituencies (representing the largest floating-rate market) on spread methodologies and documentation with respect to these and other adjustment challenges from the LIBOR regime, and the CME efforts to establish a standardized futures contract based on the SOFR, will, we believe, be very helpful as models for the broader financial sector.

4. Market sector coordination, transparency, and integrity with respect to rate calculations

CREFC encourages continued cooperation and coordination among the Board, CME, Financial Stability Board, ISDA, International Organization of Securities Commissions (IOSCO), other central banks, *and* private industry groups and stakeholders to produce a cohesive LIBOR replacement regime that could be used by a broad range of market segments (e.g., for CRE - derivatives, whole-loan lenders, CMBS, etc.)—and we applaud the level of coordination and inclusion that appears to be taking place so far. We also generally support the Board’s proposal of high-integrity rates, which are based on a deep, liquid market and are not easily manipulated, and the transparent manner in which the Board considering these rates and the data/data processes that will go into the calculation thereof.

Although CREFC has questions surrounding the mechanics of the Board’s proposed rates as potential LIBOR replacements, we see several positive features within the proposal. Beyond those referenced above (i.e., coordination among market sectors, high integrity of rates, transparency in processes, etc.), we recognize that the proposed risk-free rates could facilitate different types of market activities, including: debt and equity pricing and valuations, hedging activities, asset and liability management, etc. We also expect that Treasury repo rates could have some global applicability and correlate to some extent with benchmark rates being adopted in other jurisdictions (e.g., UK, Japan), which may help minimize impact on cross-border activities. All of these elements of the proposal align with CREFC’s general principles and goals for a LIBOR replacement regime.

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Again, we appreciate the Board's efforts to develop optional benchmark tools for the market. Given the high level of uncertainty surrounding the transition from LIBOR, publication of usable benchmark rates as soon as possible is crucial, and should be followed as quickly as possible by the development of a term structure for the overnight rate.

CREFC is establishing a working group to develop positions and initiatives supporting the transition from LIBOR to an alternative benchmark and would be glad to support the Board in an advisory capacity or otherwise. In the meantime, open communication and transparency between various governmental and private stakeholders will contribute to the development of a coherent, widely applicable replacement regime with appropriate adjustment tools for market participants.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink that reads "Lisa A. Pendergast". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Lisa Pendergast
Executive Director
CRE Finance Council