The Real Estate Roundtable

November 26, 2018

The Honorable Jerome H. Powell
Chairman, Board of Governors
Federal Reserve System
20th St. & Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1621; RIN 7100-AF-15
Email: regs.comments@federalreserve.gov

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AE90
Email: comments@FDIC.gov

The Honorable Joseph M. Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC-2018-0026
Email: regs.comments@occ.treas.gov

Re: Regulatory Capital Treatment for High Volatility Commercial (HVCRE) Exposures

Ladies and Gentlemen:

The Real Estate Roundtable[1] (www.rer.org) is pleased to provide the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "Agencies") with comments regarding their notice of proposed rulemaking (NPR) to revise the regulatory capital rule's definition of "high volatility commercial real estate (HVCRE) exposure" to conform with the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan," in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Act").

[1] The Real Estate Roundtable and its members lead an industry that generates more than 20 percent of America's gross national product, employs more than 9 million people, and produces nearly two-thirds of the taxes raised by local governments for essential public services. Our members are senior real estate industry executives from the U.S.'s leading income-producing real property owners, managers and investors; the elected heads of America's leading real estate trade organizations; as well as the key executives of the major financial services companies involved in financing, securitizing, or investing in income-producing properties.

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The Real Estate Roundtable supports the Agencies' efforts to ensure the safety and soundness of the banking system; promote economically responsible commercial real estate lending that reflects sound underwriting and risk management practices; and to sustain the stability and reliability of commercial real estate capital and credit markets. Consistent with the principles expressed in the Basel III, we believe the NPR will more realistically align the risk-taking associated with commercial real estate ADC lending with adequate risk capital to produce a sound foundation for enhanced stability and liquidity in commercial real estate markets.

Although the Real Estate Roundtable generally supports the Basel III Rules, we have repeatedly encouraged the Agencies to take appropriate steps to quickly modify or further clarify certain aspects of the rules related to HVCRE exposures that are discussed in the 2015 Frequently Asked Questions (FAQs) on High Volatility Commercial Real Estate (HVCRE) Exposures. Through enactment and effective implementation of the Act, the concerns we raised in our 2015 comment letter and in subsequent meetings and communications have largely been addressed.

Nonetheless, we encourage the Agencies to ensure that the final rule clarifies that the definitions and interpretations in the Act supersede the formerly proposed 2015 FAQs and the 2017 Proposed Simplifications of and Revisions to the Capital Rule for HVADC Exposures and that these formerly proposed rule and FAQs are rendered null and void.

The NPR would revise the definition of an HVCRE exposure to conform to the statutory definition of a high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan, which includes a credit facility that:

- Is secured by real property; primarily finances, has financed, or refinances acquisition, development, or construction of real property; has the purpose of providing financing to acquire, develop, or improve such real property into income-producing property; and is dependent on future income or sales proceeds from, or refinancing of, such real property for repayment.

The NPR also would exclude loans financing the acquisition, development or construction of the following real properties:

- One-to four-family residential properties; community development projects; agricultural land; existing income-producing property secured by permanent financings; certain commercial real property projects; real property where the loan has been reclassified as a non-HVCRE ADC loan; and real estate where the loan was made before January 1, 2015.

- Finally, the NPR proposes interpretations of certain terms generally consistent with their usage in other statutes and relevant regulations or the instructions to the Call Report.

The Act offers a number of avenues for commercial real estate exposures to be exempt from or be relieved of HVCRE status. It allows the FIRREA compliant appraised value of the property being developed to count as a capital contribution, providing another avenue for projects to reach the minimum 15 percent threshold.

The Act also provides for the following clarifications to the capital rule:

- Once the development/construction risk period has passed, and the project is cash flowing, it would allow borrowers to use internally generated cash outside the project, rather than forcing them to refinance the loan (possibly away from the original lender).

- Clarifies that loans made to do general upgrades and other improvements on existing properties with existing or continuing rental income, even after acquisition, do not trigger the capital penalty.

- Allows banks to establish borrower land value as equity into projects as established by certain safeguards, such as a fully FIRREA compliant appraisal and thorough bank review.

- Excludes from application and compliance any loans made before January 1, 2015.

We appreciate that the Agencies' NPR essentially emulates the statutory text and are encouraged by the Agencies' efforts to provide additional clarity on certain definitions. Acquisition, development and construction loans that meet certain criteria will not have higher risk-weights under risk-based capital rules.

Commercial construction lending processes and bank portfolios are subject to strong regulatory oversight, including regular reviews and targeted examinations. Risk management practices at banks include closely monitoring project performance for internal risk rating purposes and for setting of reserves.

With this NPR, however, the Agencies have proposed the concept of a "project" to define the scope of an "as completed" appraisal in multiple phased projects to determine the amount for the contributed capital exclusion. The need for this demarcation is not clear. It is already clear that Bank determination of HVCRE status is by commitment and the capital exclusion amount is set by an accepted FIRREA compliant appraisal. Not all phases can be viewed or easily valued as "projects". Requiring multiple appraisals can be redundant. Further, it seems likely that this will interfere with successful industry practice regarding liens on total project land at origination, future subdivision and collateral releases on completed phases. The regulators should drop this section in the final rule.

Overall, we recommend that any additional regulations or guidance on the scope and definitions of HVCRE adhere to principles of simplicity and clarity contained in Section 214 of the Act.

Nonetheless, we believe that, overall, the NPR more realistically aligns the requirements for HVCRE loans on commercial real estate projects with the actual periods of development or construction risk. For this reason, we believe that, when implemented, the NPR will aid economic growth and job creation, while maintaining adequate capital levels to manage the risks associated with ADC lending.

Solicit Industry Feedback

As we have previously stated, it is also important to actively understand the economic impact the Basel III Rules and other regulations could have on commercial real estate markets and the broader economy. Accordingly, it is vital that the Agencies appropriately monitor the application and administration of such rules to ensure that such application and administration is balanced, consistent and otherwise conforms to the Agencies' intentions.

As one element of such monitoring, the Roundtable respectfully suggests that the Agencies sponsor periodic industry forums. These forums would permit institutions, their customers, and other interested parties to provide transparent feedback to the Agencies on the implementation of the capital rules in the field. Such public forums, held on a quarterly or semiannual basis, could serve as an early warning system to alert the Agencies regarding potential issues with respect to the administration and implementation of the capital rules.

This feedback would allow the Agencies to appropriately address any possible unintended economic consequences resulting from the regulation by supervisory personnel or by the institutions they supervise that might threaten the soundness of the banking system or the stability of the real estate lending market on which such soundness depends in significant part.

Commercial banks constitute our nation's largest source of commercial real estate financing – so it is vital that they remain reliable source of liquidity for the industry.

We trust that the Agencies will find our few comments helpful. Should you have questions or require additional information, please contact Clifton E. Rodgers, Jr., by telephone at (202) 639- 8400 or by email at crodgers@rer.org.

Thank you for the opportunity to comment on this important issue.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer