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Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (FDIC: RIN 3064–AF29);(OCC: Docket ID OCC-2023-0008); (Federal Reserve: Docket No. R–1813).

To Whom It May Concern:

On behalf of the nearly 100,000 combined members of the National Multifamily Housing Council ("NMHC")[1] and the National Apartment Association ("NAA"),[2] ("the associations") we submit these comments in response to the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Board of Governors of the Federal Reserve System ("Federal Reserve") (together the "banking agencies"), Notice of Proposed Rulemaking for Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity ("Basel III Proposal"). We are committed to addressing the nation's pressing housing needs; however, we face serious obstacles in addressing rising housing costs and delivering much-needed supply. While the scope of the Basel III Proposal directly impacts large banking organizations, there are several indirect impacts on a wide range of housing providers, including institutions involved in the commercial real estate market and multifamily housing.

Over one-third of Americans rent their housing, and 38.9 million of them live in multifamily apartment homes consisting of five or more units. For more than 26 years, NMHC and NAA have partnered to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership,

[1] Based in Washington, D.C., NMHC is a national nonprofit association that represents the leadership of the apartment industry. Our members engage in all aspects of the apartment industry, including ownership, development, management and finance, who help create thriving communities by providing apartment homes for 38.9 million Americans, contributing $3.4 trillion annually to the economy. NMHC advocates on behalf of rental housing, conducts apartment-related research, encourages the exchange of strategic business information and promotes the desirability of apartment living.

[2] NAA serves as the leading voice and preeminent resource through advocacy, education, and collaboration on behalf of the rental housing industry. As a federation of 141 state and local affiliates, NAA encompasses over 95,000 members representing more than 11.6 million apartment homes globally. NAA believes that rental housing is a valuable partner in every community that emphasizes integrity, accountability, collaboration, community responsibility, inclusivity and innovation.

development, management, and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of 141 state and local affiliates, NAA encompasses over 92,000 members representing more than 11.8 million apartment homes globally.

I. Background of the Rules Impact

The Basel III Proposal contains several provisions that would increase capital requirements for banks covered under the scope thereof, including the following:[3]

- **Expanded Risk-Based Approach ("EBRA")**: The Basel III Proposal would replace internal models-based capital requirements for credit and operational risk currently included in Category I or II capital standards with new, risk-sensitive standardized requirements that would apply to all banking organizations with $100 billion or more in total assets;
- **Consistency in Requirements:** The Basel III Proposal would require all banking organizations with $100 billion or more in total assets to calculate regulatory capital in a consistent manner, including by reflecting unrealized gains and losses on available-for-sale securities in regulatory capital to better reflect actual loss-absorbing capacity. Additionally, the proposal would require all banking organizations with $100 billion or more in total assets to meet the supplementary leverage ratio requirement[4] and apply the countercyclical capital buffer, if activated.[5]
- **Global Systemically Important Banks ("G-SIBs"):** U.S. G-SIBs would continue to be subject to a risk-based capital surcharge, and Category I banking organizations would continue to be subject to the enhanced supplementary leverage ratio.
- **Dual-Requirement for Risk-Weighted Asset Amounts Calculations**: The Basel III proposal would maintain the capital rule's dual-requirement structure and require large banking organizations to calculate risk-weighted asset amounts under the current standardized approach and the expanded risk-based approach and use the higher of the two risk-weighted asset amounts to satisfy minimum capital requirements.
- **Transition Period**: The Basel III proposal would phase in the requirements over three years, such that the new provisions would be fully implemented starting in the fourth year after the effective date of the rule.

With respect to risk weights for credit risk (used in the ERBA calculation described above), ERBA retains many of the same definitions of the existing capital rule, including a sovereign, a sovereign exposure, certain supranational entities, a multilateral development bank, a public sector entity, a Government Sponsored Enterprise ("GSE"), other assets, and a commitment. Some elements of the proposed expanded risk-based approach for credit risk would apply the

[3] Interagency Overview of the Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule, available at https://www.federalreserve.gov/aboutthefed/boardmeetings/basel-iii-reforms-overview-20230727.pdf (July 27, 2023).

[4]Under the supplementary leverage ratio requirement, a banking organization must maintain a minimum amount of capital relative to its on- and off-balance-sheet exposures.

[5] The countercyclical capital buffer is a macroprudential tool that the agencies may decide to activate based on a range of macroeconomic, financial, and supervisory information.

same risk-weight treatment provided in subpart D of the current capital rule (current standardized approach) for on-balance sheet exposures, including exposures to sovereigns, certain supranational entities and multilateral development banks, GSEs in the form of senior debt and guaranteed exposures, Federal Home Loan Bank ("FHLB") and Federal Agricultural Mortgage Corporation ("Farmer Mac") equity exposures, public sector entities ("PSEs"), and other assets. The proposal would also apply the same risk-weight treatment provided in the current standardized approach to the following real estate exposures: pre-sold construction loans, statutory multifamily mortgages,[6] and high-volatility commercial real estate ("HVCRE") exposures.

The Basel III Proposal applies ERBA for exposures to depository institutions, foreign banks, and credit unions; exposures to subordinated debt instruments, including those to *GSEs*; and *real estate, retail, and corporate exposures*. Additionally, a banking organization would determine the risk-weighted asset amount for an on-balance sheet exposure by multiplying the exposure amount by the applicable risk weight, consistent with the method used under the current standardized approach. It would group credit risk exposures into the following categories: sovereign exposures; exposures to certain supranational entities and multilateral development banks; exposures to GSEs; exposures to depository institutions, foreign banks, and credit unions; exposures to PSEs; *real estate exposures*; retail exposures; corporate exposures; defaulted exposures; exposures to subordinated debt instruments; and off-balance sheet exposures.

The proposed categories with amended risk-weight treatments relative to the current standardized approach include *equity exposures to GSEs* and *exposures to subordinated debt instruments issued by GSEs*; exposures to depository institutions, foreign banks, and credit unions; exposures to subordinated debt instruments; *real estate exposures*; retail exposures; corporate exposures; defaulted exposures; and some off-balance sheet exposures such as commitments.

Notably, the Basel III Proposal defines real estate exposure as an exposure that is neither a sovereign exposure nor an exposure to a PSE and that is (1) a residential mortgage exposure, (2) secured by collateral in the form of real estate, (3) a pre-sold construction loan, (4) a statutory multifamily mortgage, (5) a HVCRE exposure, or (6) an acquisition, development, or construction ("ADC") exposure. A pre-sold construction loan, a statutory multifamily mortgage, and an HVCRE exposure are collectively referred to as statutory real estate exposures. On a positive note, under the proposal, the risk weight treatment for statutory real estate exposures that are not defaulted real estate exposures would be consistent with the current standardized approach.

Additionally, it would differentiate the credit risk of real estate exposures that are not statutory real estate exposures by introducing the following categories: (1) regulatory residential real

[6] Statutory multifamily mortgage means any multifamily residential mortgage that: (1) Meets the requirements under section 618(b)(1) of the RTCRRI Act, and under 12 CFR part 3, appendix A, section 3(a)(3)(v) (for national banks); 12 CFR part 208, appendix A, section III.C.3. (for state member banks); 12 CFR part 225, appendix A, section III.C.3. (for bank holding companies); 12 CFR part 325, appendix A, section II.C. (for state nonmember banks); or 12 CFR 567.1 (definition of "qualifying multifamily mortgage loan") and 12 CFR 567.6(a)(1)(iii) (for savings associations); and (2) Is not on nonaccrual.

estate exposures, (2) regulatory commercial real estate exposures, (3) ADC exposures, and (4) other real estate exposures. The applicable risk weight for these non-statutory real estate exposures would depend on (1) whether the real estate exposure meets the definitions of regulatory residential real estate exposure, regulatory commercial real estate exposure, ADC exposure, or other real estate exposure; (2) whether the repayment of such exposures is dependent on the cash flows generated by the underlying real estate (such as rental properties, leased properties, or hotels); and (3) in the case of regulatory residential or regulatory commercial real estate exposures, the loan-to-value ("LTV") ratio of the exposure.

Under the Basel III Proposal, a regulatory residential real estate exposure is defined as a first-lien residential mortgage exposure that is not a defaulted real estate exposure, an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure, subject to the below criteria:

- The loan would be required to be secured by a property that is either owner-occupied or rented;
- The exposure would be required to be made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property;
- During the underwriting process, the banking organization would be required to apply underwriting policies that account for the ability of the borrower to repay based on clear and measurable underwriting standards that enable the banking organization to evaluate these credit factors; and
- The property must be valued in accordance with the proposed requirements included in the proposed LTV ratio calculation.

The Basel III Proposal defines a regulatory commercial real estate exposure as a real estate exposure that is not a regulatory residential real estate exposure, a defaulted real estate exposure, an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure, subject to the below criteria:

- The exposure must be primarily secured by fully completed real estate;
- The banking organization must hold a first-priority security interest in the property that is legally enforceable in all relevant jurisdictions;
- The exposure must be made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property;
- During the underwriting process, the banking organization must apply underwriting policies that account for the ability of the borrower to repay in a timely manner based on clear and measurable underwriting standards that enable the banking organization to evaluate these credit factors, and the property must be valued in accordance with the proposed requirements included in the proposed LTV ratio calculation under the proposed rule.

For GSEs, the Basel III Proposal assigns a 20 percent risk weight to exposures that are not equity exposures, securitization exposures, or exposures to a subordinated debt instrument issued by a GSE, consistent with the current standardized approach. Similar to the treatment of senior debt

exposures to GSEs and GSE exposures that are not equity exposures or exposures to a subordinated debt instrument issued by a GSE, the proposal would apply the same 20 percent risk weight to all exposures to FHLB or Farmer Mac, including equity exposures and exposures to subordinated debt instruments, which continues the treatment under the current standardized approach. An exposure to a subordinated debt instrument issued by a GSE must be assigned a 150 percent risk weight, unless issued by a FHLB or Farmer Mac. Equity exposures and exposures to subordinated debt instruments would be subject to an increased risk-based capital requirement to reflect their heightened risk relative to exposures to senior debt.

II. NMHC and NAA Comments

As an overarching matter, the associations are concerned that the Basel III Proposal will harm the economy and make capital, in general, more difficult to obtain. This, in turn, will reduce the availability for banks to make multifamily loans. If it is harder for banks to lend, it will be harder for housing providers to obtain capital to build and, thus, provide affordable housing. It is well documented that the country faces a nationwide housing affordability challenge and a historic demand for rental housing.[7] Beginning in the mid-2000s, the nation experienced the greatest renter wave in its history as the number of households that rent rose by more than 7 million.[8] Fueled by this extraordinary demand for apartment homes, NMHC and NAA recently conducted research, finding that 4.3 million new apartment homes need to be built by 2035 to meet the nation's demand for rental housing.[9] This includes an existing shortage of 600,000 apartments stemming from underbuilding, due in large part to the 2008 financial crisis.

Underproduction of housing has translated to higher housing costs and has resulted in a consequential loss of 4.7 million affordable housing units (those with rents less than $1,000 per month) from 2015-2020.[10] In addition, the total share of cost-burdened apartment households (those paying more than 30 percent of their income on housing) has increased steadily over several decades, reaching 57.6 percent in 2021.[11] During this same period, the total share of severely cost-burdened apartment households (those paying more than half of their income on housing) increased from 20.9 to 31.0 percent.[12]

Our data indicates that the primary and uniform solution to the nation's affordable housing crisis is to expand the supply of affordable housing, including multifamily housing. Making capital more difficult to obtain, as the Basel III Proposal does, will exacerbate this crisis. Specifically, the Basel III Proposal admits, "As a result of the increases in risk-weighted assets, the agencies estimate that the proposal would increase the binding common equity tier 1 capital requirement,

[7] Hoyt Advisory Services, Estimating the Total U.S. Demand for Rental Housing by 2035 available at https://www.weareapartments.org; NMHC Quick Facts, available at https://www.nmhc.org/research-insight/quick-facts-figures/.
[8] U.S. Census Bureau, Various Surveys.
[9] *See* Hoyt Advisory Services.
[10] American Housing Survey, U.S. Census Bureau, "NMHC tabulations of 1985 American Housing Survey microdata." (2021).
[11] *Id.*
[12] *Id.*

including minimums and buffers, of large holding companies by around 16 percent."[13] Additionally, the banking agencies fail to provide a quantitative analysis that supports the need to increase the capital by this much, or a full analysis of its financial impact. The multifamily housing industry relies on banks in a variety of areas, including construction loans, warehouse financing, medium- and long-term debt, mortgage banking, Low-Income Housing Tax ("LIHTC") loans, and equity and loan servicing, all of which could be impacted if banks have significantly less capital to deploy.

Additionally, we offer the following specific points on the Basel III Proposal:

- **Defaulted Exposures** The Basel III Proposal definition of defaulted exposure would look to the performance of the borrower with respect to credit obligations to any creditor.[14] Specifically, if the banking organization determines that an obligor meets any of the defaulted criteria for exposures that are not retail exposures, the proposal would require the banking organization to treat all exposures that are credit obligations of that obligor as defaulted exposures.[15] Additionally, it would differentiate the criteria for determining whether an exposure is a defaulted exposure between exposures that are retail exposures and those that are not.[16] This is particularly troublesome since each multifamily property is underwritten based on the value of the real estate and is frequently placed in a bankruptcy-remote entity that carries no available cross-collateralization or cross-default provisions, unless specifically stated in the loan documentation. Placing all exposures to one borrower in default ignores the performance of the other bankruptcy-remote entities. This ignores the fact that the bank has no remedies available with the other entities and may violate the terms of the loan agreement. This provision should be removed entirely.

  As is outlined in an OCC handbook, the underwriting for a CRE loan includes several factors. [17] It states,

  > SLTV limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and the construction of an office building), the appropriate LTV limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. When a loan is fully cross-collateralized by two or more properties or secured by a collateral pool of two or more properties, the appropriate maximum loan amount under SLTV limits is the sum of the value of each property, less senior liens, multiplied by the appropriate LTV limit for each property. To ensure that

[13] Basel III Proposal, 88 FR 64028, 1701.
[14] Basel III Proposal, 88 FR 64028, 239.
[15] *Id.*
[16] *Id.*
[17] Comptroller's Handbook, Safety and Soundness, Commercial Real Estate Lending, Version 2.0, *available* at https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/commercial-real-estate-lending/pub-ch-commercial-real-estate.pdf. (March 2022).

> collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.[18]

The Basel III Proposal would treat all exposures that are credit obligations of that obligor as defaulted exposures, creating new onerous factors in this underwriting process.

- **Securitizations** The Basel III Proposal would increase the capital requirements for most exposures to securitizations, including commercial mortgage-backed securities ("CMBS") and CRE collateralized loan obligations ("CLOs"). The CMBS industry has annually accounted for approximately 10 percent of the mortgage debt outstanding to the multifamily industry since its inception in 1995. This peaked in 2007 at nearly 17 percent of the total debt market, but is now closer to 7 percent. CMBS was already facing strong headwinds due to the departure of many market participants and the volume of complex regulations associated with it. The Basel III Proposal would add further complexity in this area. CLOs are frequently used by debt funds to provide liquidity to their multifamily loan originations and to distribute the credit risk on those loans. Debt funds have played an increasingly important role in providing loans on multifamily properties. The Basel III Proposal would result in decreasing the availability of this important source of funding for affordable housing.

- **LIHTC** Capital The value of the LIHTC is widely recognized by lawmakers and regulators. Given the nation's severe shortage of affordable housing, Congress in recent years has enacted significant improvements to the LIHTC program. In December 2020, Congress established a minimum 4 percent credit rate, akin to current law's minimum 9 percent credit rate, so that investors may derive its full value. The LIHTC has developed or preserved 3.7 million apartments since 1986. More consideration must be given to how the LIHTC could be impacted by the Basel III Proposal and whether it is appropriate to apply a lower risk rating to LIHTC that is comparable to multifamily housing.

- **FHLB Debt Treatment** The Basel III Proposal would also limit preferred treatment for FHLB debt with regard to collateralized transactions. Similar to the treatment of senior debt exposures to GSEs and GSE exposures that are not equity exposures or exposures to a subordinated debt instrument issued by a GSE, the proposal would apply the same 20 percent risk weight to all exposures to FHLB or Farmer Mac, including equity exposures and exposures to subordinated debt instruments, which continues the treatment under the current standardized approach.[19]

  The FHLB system's statutory mission is to support affordable housing and community development in several ways, most notably by providing FHLB members with reliable sources of liquidity via advances for housing finance, community lending, and asset liability management needs. In addition, the FHLB system offers a number of affordable housing and community development programs and initiatives, including, most notably,

[18] *Id.*
[19] Basel III Proposal, 88 FR 64028, 254.

the Affordable Housing Program ("AHP") and the Community Investment Program ("CIP"). The traditional focus of FHLB advances and programs such as AHP and CIP has been on single-family housing and/or home ownership. However, recently, an FHFA report[20] encouraged the FHLB system to increase multifamily housing. This is an important step forward, and we urge that precautions be taken to ensure lending from the FHLB system is not harmed by the Basel III Proposal.

- **Credit Risk Transfer** We support the banking agencies providing as many risk management tools to banks as possible to ensure banks' safety and soundness while preserving access to capital and avoiding increased costs of capital. One such cost-efficient risk management tool, which is used by banks in other countries that have implemented Basel III endgame, is credit risk transfer provided by highly regulated and diversified insurers and reinsurers. For over a decade, the government-sponsored Enterprises, Fannie Mae and Freddie Mac, at the direction of their conservator and regulator, the Federal Housing Finance Agency (FHFA), have successfully used insurance and reinsurance credit risk transfer, and increasingly, when capital markets options for risk transfer are not available. Other federal and state programs in the U.S., as well as the private insurance industry, also successfully use it.

III. Conclusion

The associations appreciate the opportunity to provide a response to the Basel III Proposal. As always, we remain committed to working with federal regulators, the Administration, and policymakers in Congress to address our shared goal of expanding affordable housing opportunities nationwide.

That said, we remain concerned that the Basel III Proposal would harm renters and homeowners by making it more expensive, complicated, and unworkable to obtain capital for housing providers.

Sincerely,

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National Apartment Association

Sharon Wilson Géno
President
National Multifamily Housing Council

[20] Federal Housing Finance Agency, FHLBank System at 100: Focusing on the Future Report, available at https://www.fhfa.gov/AboutUs/Reports/Pages/FHLBank-System-at-100-Report.aspx (Nov. 7, 2023).