The Real Estate Roundtable

October 30, 2013

Board of Governors of the Federal Reserve System, Robert deV. Frierson, Secretary
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Federal Deposit Insurance Corporation
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Department of Housing and Urban Development,
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Office of the Comptroller of the Currency
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Re: Proposed Rule (Release Nos. 34-70277), Credit Risk Retention - Federal Reserve Docket No. R-1411; FDIC RIN 3064-AD74; OCC Docket Number OCC-2013-0010; SEC File Number S7-14-11; FHFA RIN 2590-AA43

Ladies and Gentlemen:

The Real Estate Roundtable is pleased to submit this letter in response to the joint-agency (Agencies) request for comments regarding the re-proposed rules to implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 (the Re-proposed rules) in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act).

The Real Estate Roundtable represents the principal owners, investors and managers of the U.S. income producing commercial and multifamily real estate sector. As such, we recognize the goal of the Agencies is to provide greater integrity and discipline in domestic and international capital markets. 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 nation’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.

Commercial real estate markets continue to recover from the most severe economic downturn since the Great Depression. Credit to the sector virtually shut down in 2008 and only began to return in a limited capacity in 2010. As one of the largest sources of credit for commercial and multifamily real estate in the United States, the commercial mortgage backed securities (CMBS) market is an important element of the over $3 trillion commercial real estate debt market, currently comprising roughly 26 percent of the overall market. It is essential to have a healthy and disciplined new-issuance CMBS market.

The Real Estate Roundtable supports efforts to promote economically responsible commercial real estate lending that reflects sound underwriting and risk management practices, and rational pricing of economic risk. We continue to urge policymakers to take action that encourages stable valuations, enhanced transparency and sensible underwriting, and support efforts to establish appropriate systemic safeguards—all key factors for a reliable credit system.

Within this context, we appreciate the Agencies' efforts to ensure that the commercial real estate lending market function with an appropriate level of integrity and discipline. Although risk retention may be intended to safeguard bondholders, it also introduces the potential to raise costs for borrowers or to limit the amount of credit and liquidity that are available, particularly to borrowers in secondary and tertiary markets.

We commend the Agencies for making revisions to the originally proposed regulations, as issued on April 29, 2011. Despite a number of constructive revisions, we remain concerned about the serious and, presumably, unintended economic consequences that the re-proposed rules could have on a reliable new issuance market for commercial mortgage backed securities (CMBS) and overall commercial and multifamily real estate credit capacity. For this asset class, we have the following concerns:

Appropriate Alignment of Interests. A key assumption underlying the originally proposed rules is that by requiring a CMBS sponsor to retain an economic interest in its securitized assets, the sponsor's interest will be more closely aligned with the interests of CMBS investors. However, we remain concerned that neither the originally proposed rules nor the re-proposed rules acknowledge or account for existing "incentive alignment mechanisms"[1] and forms of risk retention such as the existing B-piece investor retention and special servicing structure for CMBS which serve to appropriately align incentives and create "skin in the game".

Cost Benefit Analysis. The originally proposed rules failed to acknowledge and build on these forms of risk retention. In the Federal Reserve's "Report to the Congress on Risk Retention"[2], the Board recommended that the Agencies responsible for implementing credit risk retention take into account a number of factors "in order to help ensure that the regulations promote the purposes of the Act without unnecessarily reducing the supply of credit."[3] This report notes that overcollateralization, subordination, third-party credit enhancement, representations and warranties and conditional cash flows all serve a similar purpose.[4] While an improvement over the original proposal, the re-proposed rules still do not appear to fully address these factors.

Additional concerns have been raised by the Financial Stability Oversight Council in a Dodd-Frank mandated report[5] regarding the potentially negative macroeconomic effects that the proposed risk retention rules could trigger which warns that "if regulators set risk retention requirements at an inappropriate level, or design them in an inappropriate manner, the costs in terms of lost long-term output could outweigh the benefits of the regulations."[6] Given the fragile state of the U.S. economy and the important role of CMBS in commercial real estate finance markets, this broader economic view is of vital concern to commercial real estate – particularly for "smaller market participants".[7]

The Senate Banking Committee also urged the Agencies to fully understand the economic impact these credit risk retention rules could have on the overall economy by conducting a rigorous cost-benefit and economic impact study prior to implementation – given the "potential harm to our already

[1] Federal Reserve Report, 3-4.
[2] Board of Governors of the Federal Reserve System, "Report to the Congress on Risk Retention" (October 2010).
[3] Federal Reserve Report, 3-4.
[4] Federal Reserve Report, 41-43.
[5] Financial Stability Oversight Council, "Macroeconomic Effects of Risk Retention Requirements" (January 2011).
[6] FSOC Report, 30
[7] Federal Reserve Report, 3-4.

weak economy and the public from ill-conceived rules."[8] Such an analysis should specifically address how the proposed CMBS risk retention requirements could affect overall credit capacity for commercial real estate and how a potential reduction in liquidity will affect borrowers, the credit markets and the overall economy.

We are, therefore, disappointed that the Agencies did not accept the suggestion made in our August 1, 2011 letter recommending that a comprehensive cost benefit analysis be conducted of how the proposed rules will affect commercial real estate and the overall national economy before the rules are finalized. As such, we concur with the dissenting view of SEC Commissioner Michael S. Piwowar regarding the re-proposed risk retention rules. Commissioner Piwowar stated that, although improvements were made to the original proposal in response to public comments, he did not support the re-proposal because it does not contain necessary economic analysis, nor does it adequately consider alternatives to credit risk retention requirements.

We continue to urge that the Agencies make every effort to understand the economic impact these re-proposed credit risk retention rules could have on the overall economy by conducting a rigorous cost-benefit and economic impact study prior to implementation – given the "potential harm to our already weak economy and the public from ill-conceived rules."

Retention Structures. We commend the Agencies for eliminating the controversial *premium capture cash-reserve account* (PCCRA) provision in the revised proposal. We also commend you on devising a new methodology for permitting greater flexibility in the structure a sponsor utilizes to meet the retention requirement. Under the re-proposed rule, a sponsor may retain any combination of horizontal (*eligible horizontal interest*) and/or vertical economic interest (*eligible vertical interest*) in a CMBS securitization transaction, provided that those interests generally equal at least 5 percent of the *fair value* of the securitization transaction in the aggregate. Under this newly proposed calculus, however, the retention piece would usually be larger than if it were calculated based on the *par value*. This re-proposed structure permits greater flexibility in meeting the retention requirements but will still result in higher retention levels than the current structure. We have concerns that basing the retention calculation on *fair value* measurements, instead of the *par value* of securities, as originally proposed, will lead to dramatically higher retention levels than the current structure, requiring additional investor capital. Such an increase will unduly result in higher borrowing costs and may fuel a preference for higher yielding, more risky loans.

Term. The original proposal called for only one party to retain a 5 percent risk piece of every transaction and retain it for the life of the transaction. Under the re-proposal, the parties that retain a transaction's risk piece would be able to trade out of that position after five years. While the re-proposal is more flexible than the original proposal, this still places onerous term restrictions on investors. There are also restrictions on the sponsor and/or B-piece buyer hedging their positions during the risk retention period. Such a structure creates a disincentive for investors and could drive up borrowing costs. Indeed, how can an insured depository institution participate in this market and balance safety and soundness concerns? Despite improvements to the original proposal, we remain concerned that the five year term creates disincentives for investors that could undermine market liquidity.

Qualified Commercial Real Estate (QCRE) Mortgages Should Follow More Realistic Guidelines. We had hoped that a more realistic set of criteria could be developed for qualification to exempt certain CMBS from the risk retention construct. While modest improvements have been made, the re-proposed parameters stipulate uncharacteristically low leverage and high debt service coverage levels for commercial and multifamily real estate loans. We agree with notion of reducing or eliminating the risk retention piece for CMBS loans that are conservatively underwritten. The inclusion of such qualifying loans in a CMBS transaction would reduce the overall risk-retention requirement, but very

[8] Letter dated February 15, 2011 to The Honorable Timothy Geithner, Secretary, The Department of Treasury, et al., and letter dated May 4, 2011 to Elizabeth A. Coleman, Inspector General, Federal Reserve Board, et al.

few, if any, current loans would qualify. It would be entirely more feasible to have more realistic parameters under which a commercial or multifamily real estate loan would qualify for this designation.

For example, insurance company and commercial bank lenders have the lowest incidence of delinquency[9] for commercial and multifamily loans. Since loans originated by balance sheet lenders such as insurance companies and commercial banks outperform loans from other sources, we recommend following the guidelines utilized by such lenders. As such, we suggest utilizing a capitalization rate, loan-to-value ratio, debt service coverage ratio and amortization schedule for commercial and multifamily real estate loans more typical of these balance sheet lenders. By following more realistic industry standards in the qualification parameters, the Agencies would have a better chance of seeing higher quality assets in QCRE commercial mortgage securitizations.

With efforts underway to reform the nation's Government Sponsored Enterprises (GSEs), the importance of having a viable CMBS market is more important than ever -- given the fact that a significant percentage of the multifamily market is financed through either Fannie Mae or Freddie Mac. Should reform efforts take the GSEs out of the multifamily finance market or further reduce their multifamily issuance capacity, having a reasonable qualification for multifamily mortgages is vital to maintain credit flows to the multifamily sector.

Therefore, it is vitally important for the Agencies to create realistic parameters under which a CMBS loan may qualify for appropriate reduction or elimination of the risk retention piece for CMBS.

Single-Borrower/Single-Credit (SBSC) Transactions Should be Exempt from Risk Retention. One important asset class of CMBS that currently does not require a risk retention piece is the single-borrower/single-credit (SBSC) transaction. SBSC CMBS transactions represent an important source of credit for the commercial and multifamily real estate sector and are a subset of the broader CMBS market. Compared to conduit transactions that average 100 or more loans per pool, SBSC transactions are less complex and contain only one loan (or a handful of cross-collateralized loans that essentially function as one loan). The SBSC market has the highest credit quality characteristics of any securitization asset class, with losses of roughly 20 basis points over time versus an average of nearly 4 percent for conduit transactions and over 6 percent for private label residential securitizations. Moreover, the SBSC asset class serves as an important source of credit for large-scale commercial real estate properties – where securitization is the only option. In this sense, they often involve only one loan (or a pool of cross-collateralized loans that essentially function as one loan) and are more similar to corporate debt than to other CMBS.

The re-proposed rule requires that all sponsors of securitizations retain a 5 percent retained interest. The rule counts B-piece buyers' holdings against the requirements for conduit transactions. However, because SBSC transactions are transparent and extremely credit-worthy, investors have not demanded a subordination to support their positions – as with conduit transactions. As such, all bonds issued out of an SBSC trust are investment grade, and there are no B-piece buyers to absorb what will be very costly requirements for the sponsors to absorb.

We are very concerned about the implications of applying a "one-size-fits-all" rule to this asset class. Sponsors estimate that the change will add at least 20 to 30 basis points to borrower costs and increase warehouse risk. This potential increase in borrowing costs could have the unintended consequence of reducing the credit quality of the underlying loans – thereby undermining the overall goal of risk retention. In addition to raising borrowing costs, the market would potentially become less liquid which could result in reduced credit capacity for the overall commercial real estate market.

[9] Differences Across Originators in CMBS Loan Underwriting, Lamont K. Black, Chenghuan, Sean Chu, Andrew Cohen, and Joseph B. Nichols, Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board, Washington, D.C. 2011-05

We, therefore, recommend that the re-proposal be revised to permit a complete exemption from risk retention for traditional SBSC CMBS transactions for commercial and multifamily properties. It is vitally important to preserve this financing vehicle for large-scale transactions – too large for traditional portfolio lenders.

REITs. We commend the Agencies for removing language that would have excluded loans against properties owned by REITs from being able to be exempt from the risk-retention rules. The re-proposal said "the agencies did not intend to exclude otherwise valid CRE loans from the definition solely because the borrower was organized as a REIT structure." We also commend the agencies for seeking to avoid unsecured REIT loans from being classified as commercial real estate loans.

Monitoring Impact of Proposed Rules

It is vital that the Agencies appropriately monitor the application and administration of the re-proposed 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 feedback to the Agencies on the implementation of the re-proposed rules in the field. Such forums, held on a 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 re-proposed rules. This feedback would allow the Agencies to appropriately address any possible concerns regarding the impact the re-proposed rule is having on the new-issue CMBS market and the overall stability of the real estate lending market.

Conclusion

We appreciate what the Agencies are trying to achieve and commend them on making progress toward a more workable re-proposal. However, we remain concerned about the impact the re-proposed rules will have on the new issue CMBS market, SBSC transactions, commercial real estate credit flows and the overall economy. Given the vast credit challenges facing commercial real estate, the fragile nature of the economy and the continued volatility in credit and capital markets, it is important to appropriately craft the re-proposed rules to ensure a properly functioning and reliable CMBS market.

Accordingly, we respectfully request that the Agencies consider making a number of further refinements to the re-proposed rules and reduce the potential for an unintended negative impact on the CMBS market and the overall economy.

Again, we appreciate this opportunity to comment, and we look forward to working constructively with the Agencies on this important matter.

We trust the Agencies may find our few comments useful. 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 this opportunity to comment on this important issue.

Sincerely,

Jeffrey D. DeBoer
President and CEO