December 20, 2017

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1576; RIN 7100 AE-74

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
550 17th Street NW
Washington, DC 20429
RIN 3064 AE-59

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street SW., Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC–2017–0018; RIN 1557–AE10

Subject: Notice of Proposed Rulemaking, "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) of 1996"

The National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) appreciate the opportunity to provide our comments to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve and Federal Deposit Insurance Corporation (collectively the "Agencies") on the Notice of Proposed Rulemaking regarding Docket ID OCC-2017-0018 pertaining to Proposed Simplifications of and Revisions to the Capital Rule for HVADC Exposures.

For more than 20 years, the National Multifamily Housing Council and the National Apartment Association have partnered on behalf of America's apartment industry. Drawing on the knowledge and policy expertise of staff in Washington, D.C., as well as the advocacy power of more than 160 NAA state and local affiliated associations, NMHC and NAA provide a single voice for developers, owners and operators of multifamily rental housing. One-third of all Americans rent their housing, and 39 million of them live in an apartment home.

The multifamily industry welcomes the regulators' openness to modifying and streamlining the existing HVCRE rule as part of the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). The regulators have received input from the

banking industry and from the commercial real estate industry that the existing rules for HVCRE are complex and lack clarity, resulting in nonstandard application and constraints on debt capital for the apartment industry.

The multifamily industry relies on the banking system to provide loans for acquisition, development and construction (ADC) activities. The industry is an important provider of apartment homes, whether through new development, renovation or the rehabilitation of existing apartments. This business model depends on ready access to debt capital to fund these activities, which are often provided by the banking industry. Regulations and rules that disrupt the flow of capital is a significant area of concern for the multifamily sector. The apartment industry is concerned that the proposed rule, in creating a new classification of ADC activities, will result in a complex, bifurcated set of rules that may impair the availability of debt needed by the multifamily industry, without reducing or managing risk more efficiently for the banking industry.

NMHC/NAA request that the proposed HVADC rule be withdrawn and instead focus on improving the existing HVCRE rule. We recommend establishing a single framework that applies to the risk targeted by HVCRE and HVADC so that only one capital regime applies to all banks.

General Comments

The creation of a new capital regime that only impacts certain banks, but leaves in place the existing HVCRE rule for others, will produce different loan pricing between banks simply due to different capital treatment for the same loan. This creates confusion for the multifamily owner or developer as they look to finance their property. A single application of a capital regime removes this ambiguity for banks when offering their loan products.

The proposed rule sweeps in more ADC loans into the higher capital regime, resulting in borrowers facing a higher capital treatment for a loan that was previously low risk. The rule justifies this broader application by attempting to simplify the loan origination process by eliminating a set of underwriting rules used to determine whether a loan should be classified as HVCRE.

One of the key provisions in simplification is to eliminate the requirement for a capital contribution from borrowers. Removal of this requirement eliminates the balance that borrowers and banks make between prudent underwriting and risk evaluations. The proposed rule now penalizes borrowers who have contributed capital, even above the 15 percent minimum in the existing rule, but now fall into the higher capital treatment. Recognizing prudently underwritten capital contributions from borrowers should be included as part of the capital regime.

If regulators elect to reinstate the capital contribution exemption, prudent underwriting should be used to remove certain other flaws in the determination and management of an HVADC/HVCRE loan.

- Recognition of the current full value of contributed land, determined as part of the appraisal and underwriting process.
- Internally generated funds and equity can be distributed before maturity or conversion up to the 15 percent required investment.
- Contributed capital can take various forms (cash, readily marketable securities, out-of-pocket development expenses paid, contributed real property or improvements) at their current market value. Contributed capital should also include preferred equity for purposes of meeting any equity contribution requirements as this form of capital contribution is permanent, does not require an interest payment and is not secured by the property.
- Utilize a loan-to-cost approach for determining the capital contribution versus an as-completed approach, which is more difficult for borrowers and banks to determine.

The proposed rule attempts to more clearly define what is an ADC loan, but falls short in several ways:

- The definition must include the term "directly secured by" real estate, in order to directly tie the loan to the property.
- By failing to include "directly secured by" in the definition, any facility used to finance an ADC loan would fall under the higher capital regime. Importantly, investment-grade REIT unsecured revolving credit facilities are evaluated and underwritten based on the financial strength of the REIT. Should the proceeds of such a facility be used for an ADC loan, the proposed rule would pull that portion of the facility under the ADC capital surcharge – requiring a substantial increase in the risk weight and a dramatic increase in the cost of borrowing for REITs, while also impacting many loan syndications. Application of the suggested modification to the definition addresses this issue.
- The definition should use a purpose-based test like the proposed rule's "primarily finances" requirement. Should a final rule retain this requirement, regulators should clarify what uses will count toward the 50% benchmark. Also, ongoing monitoring of the 50% level as required in the proposed rule is difficult and costly to implement for borrowers and banks.

NMHC/NAA welcome inclusion of an exemption for community development loans, as they serve a critical role in meeting housing affordability needs. The rule should consider that the exemption includes mixed use and mixed income properties that often have a targeted affordable component. The rule should include a proration mechanism to reflect the lower capital charge for the affordable portion of the loan.

Legislative Action

NMHC/NAA ask the Agencies to review proposed legislation to modify the existing HVCRE rule passed in the U.S. House of Representatives– Clarifying High Volatility Commercial Real Estate Loans (H.R. 2148). The proposed legislation addresses several of the issues identified as issues in defining what is an HVCRE loan. The legislation does not eliminate the Agencies' ability to require banks to hold higher capital for HVCRE loans. The bill provides greater clarity and balances risk appropriately, including what is or is not an HVCRE loan.

Among the clarifications in the legislation are the following:

- 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;
- Clarify that loans made to do general upgrades and other improvements on existing properties with rental income 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-compliant appraisal and thorough bank review; and,
- Excludes from application and compliance any loans made before January 1, 2015.

NMHC/NAA appreciate the opportunity to comment on the proposed rule and welcome the chance to work with the Agencies to develop and implement a framework that properly balances simplicity, risk management and prudent lending standards.

Sincerely,

Doug Bibby
President
National Multifamily Housing Council

Robert Pinnegar, CAE
President & CEO
National Apartment Association