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**VIA ELECTRONIC SUBMISSION**

December 21, 2017

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**

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

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**

Re: October 27, 2017, Notice of Proposed Rulemaking, Basel III High Volatility Acquisition Development or Construction (HVADC), "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996"

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 its perspectives on the Agencies' Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 issued on October 27, 2017.[2]

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[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.

[2] Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, available at: https://www.federalregister.gov/documents/2017/10/27/2017-22093/simplifications-to-the-capital-rule-pursuant-to-the-economic-growth-and-regulatory-paperwork#print

Market Square West • 801 Pennsylvania Ave., NW • Suite 720 • Washington, DC 20004 • Phone: 202-639-8400 • Fax: 202-639-8442 • www.rer.org

The comments in this letter are focused on the Notice of Proposed Rulemaking (NPR), "Simplifications of and Revisions to the Capital Rule related to High Volatility Acquisition Development or Construction (HVADC) Exposures" as issued on October 27, 2017.[3]

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. To that end, the Basel III Rules represent a good overall foundation for enhanced stability in commercial real estate lending.

We also appreciate the stated intentions of the Agencies to simplify aspects of the generally applicable capital rules related to the treatment of acquisition, development or construction (ADC) loans consistent with the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA).

The NPR would replace the definition of a High Volatility Commercial Real Estate (HVCRE) exposure in the standardized approach with a new High Volatility Acquisition, Development, or Construction (HVADC) exposure category. Some of the proposed simplifications and clarifications may increase the ADC scope, and others may decrease it.

Accordingly, the Agencies are proposing to apply a lower risk weight to the proposed HVADC exposure category, applying a 130 percent risk weight to HVADC exposures – a reduction from the 150 percent risk weight to HVCRE exposures under the current rule. It is unclear if the reduction is based on any new analysis of CRE losses or to make the proposed changes to ADC identification and reporting more palliative to standard approach banks.

The NPR would not revise the treatment of HVCRE exposures for purposes of calculating the amount of capital required under the advanced approaches. Instead, the proposal would grandfather existing ADC exposures, and advanced approach banking organizations would use the proposed HVADC exposure category for the purposes of calculating their capital requirements under the standardized approach in addition to continuing reporting under the HVCRE definition for their advanced approach capital determination.

In the NPR, the Agencies make note of observing an apparent gap in HVCRE determination and reporting by banks in the required filings of the FR Y-14 and Call Reports. Despite wide-ranging concerns raised in a multiplicity of comment letters submitted to the Agencies regarding the current HVCRE rule, the NPR does not clarify the existing HVCRE definition which continues to be required from advanced standards banks – instead it creates a new exposure category – HVADC. We raise the following concerns about the NPR:

- The bifurcation of HVCRE and HVADC exposures only complicates large bank reporting of essentially the same risk. Without one framework that would apply to both HVCRE and HVADC exposures, banks face the challenge of coordinating the respective risks of HVCRE and HVADC exposures, continuing the disruption between banks and developers over development and/or construction financing and hampering multibank syndication of larger deals. We recommend establishing a single, coordinated framework that applies to the risk targeted by HVCRE and HVADC so that one framework applies to both advanced approach and standardized approach banks.

[3] 12 CFR 217.21(Board); 12 CFR 3.21 (OCC); 12 CFR 324.21 (FDIC)

- Under the HVCRE rules, the 15 percent equity requirement for HVCRE exclusion was presented as a “skin in the game” inducement to borrowers to lower the risk weight of ADC loans. It makes no sense to eliminate this equity exemption and possibly increase the exposure risk of having less equity in the transaction, while lowering the loan’s capital surcharge rate to 130 percent.

- In addition, the NPR fails to provide clarity on the issue of what constitutes an "equity" contribution to a loan structure. For greater clarity, we direct you to the language in the House-passed HVCRE legislation[4] which allows banks to establish borrower contributed land value as equity into projects as established by certain safeguards, such as a fully-compliant appraisal and thorough bank review.

- The current and proposed rules pull many stabilized loans without construction risk into this HVCRE category, including properties acquired and being upgraded while rental income continues, unduly burdening cash flow supported loans with capital charges intended to protect banks from heightened construction risks. Many banks, including small community financial institutions, have been deterred from making this type of loan – driving the business to unregulated, higher cost debt funds.

- The NPR also fails to address the need to amend the HVCRE equity requirement for advanced standards banks that all contributed and internally generated capital remain in the project throughout the life of the loan. This requirement creates an unintended incentive to have the borrower limit their total equity contribution to just the exemption-driven 15 percent. In cases when equity greater than 15 percent is contributed, they would endeavor to repay the bank in full as soon as possible when development risk has passed in order to repatriate their equity, depriving banks of the income associated with a stabilized loan that would bolster capital.

- The NPR also ignores the fact that current exam structures within the regulators on commercial banks monitor the CRE risk on the books and verify risk processes. Plus, Comprehensive Capital Analysis and Review (CCAR) establishes its own CRE schedule and is the binding control for banks over $250 billion.

**Capturing Unsecured Cash Flow Underwritten Exposures as CRE Risk**

Expanding the ADC reporting pool by creating a purpose test will capture exposures for ADC purposes that are fully supported by other acceptable repayment sources and non-CRE secured loan structures. For example, similar to other corporate borrowers, real estate investment trusts (REITs) use a mix of revolving bank debt, term loans and privately placed and publicly issued debt securities as part of their capital structure. Investment grade rated REITs generally benefit from credit facilities that are both unsecured and on terms more favorable to the borrower than can be obtained by non-investment grade rated companies. The loans associated with these credit facilities while used for ADC purposes are *corporate* loans – not *CRE* loans – and are underwritten based on the financial strength of the overall company, its underlying assets and cash flow. A large percentage of the U.S. equity REIT market has investment grade ratings.

Equity REITs have low leverage ratios. As of January 2017, the debt-to-total market capitalization of the equity real estate investment trust (REIT) market (debt divided by the sum of debt and equity) was 31.9 percent – the lowest since the end of 1997. The debt-to-total book-assets ratio of the market was 49.0 percent, down from a post-crisis peak of 57.5 percent in the first quarter of 2009, and the lowest level on record since 2000.[5]

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[4] *Clarifying High Volatility Commercial Real Estate Loans* (H.R. 2148)
[5] *Equity REITs Have Lowest Debt Ratio In 20 Years*, NAREIT, January 9, 2017.

For these reasons, investment-grade REIT revolving bank debt has proven to be one of the safest debt exposures for banks. Should the proceeds of such a facility be used for an ADC loan, the NPR would pull that portion of the facility under the ADC capital surcharge – requiring a substantial increase in the risk weight and a dramatic increase the cost of borrowing for REITs, while also impacting many bank loan syndications. We encourage the Agencies not to undermine the structure of investment grade credit facilities and bank loan syndications by imposing a collateralized HVADC requirement on these unsecured lines.

One key underwriting factor involved in ADC lending is establishing borrower intent with regard to the purpose of the loan. In certain cases, bank documents prohibit borrowers from using credit facilities in certain ways. In order to ensure that borrowers do not use unsecured cash flow underwritten facilities for ADC purposes, banks would have to add language to their agreements which is commercially unfeasible, which could drive financing to unregulated sources.

**Current HVCRE Rules: Agencies Fail to Respond to Industry Concerns**

The Agencies have failed to respond to stakeholder questions and provide clarification of the HVCRE Rule. The lack of clarity in the Rule and subsequent HVCRE *Frequently Asked Questions* (FAQs) published by the Agencies on March 31, 2015 has resulted in a wide disparity in how banks classify their ADC portfolios as HVCRE or non-HVCRE. This result has negatively impacted ADC loan decisions for some banks, leaving some borrowers with fewer and potentially more costly sources of ADC loan capital. A slowdown in ADC lending has the potential for broader economic impact.

The Agencies' continual failure to respond to legitimate industry concerns about the need for standardization and clarity in HVCRE rules reflects an apparent lack of familiarity by their regulatory capital planning arms with the practice and dynamics of commercial real estate (CRE) lending which are well known to their own risk examination arms.

It is not clear that there is any bank safety rationale for separately requiring unclarified HVCRE reporting by advanced standards banks – instead it appears intended as a penalty on banks for offering a debt capital product for real estate development.

In addition, it is not clear that the Agencies have any empirical data or research that supports the premise of capital calculated from any such risk weight be it 130% or 150% as protecting a bank from ADC risk exposures – raising the question of whether there should be any capital surcharge at all.

As a result of the negative impact that the current HVCRE rules are having on ADC lending, a number of unregulated, shadow-market funds are filling the void. Banks risk losing their long-established, valuable CRE development customers to this growing non-banking shadow-market. Ironically, these funds utilize bank loans for leverage to meet their yield targets. While the leverage is coming from banks, the facilities are outside the scope of existing regulatory CRE reporting schemes.

**Legislative Action**

Meanwhile, the U.S. House of Representatives recently passed a bipartisan measure – *Clarifying High Volatility Commercial Real Estate Loans* (H.R. 2148) – that would help address concerns regarding the HVCRE rules by amending the Federal Deposit Insurance Act to clarify the certain requirements for certain acquisition, development, or construction loans (ADC).

The House-passed legislation addresses several specific deficiencies in the Agencies' regulations governing what is an HVCRE loan to ensure that they do not impede credit capacity or economic activity, while still promoting economically responsible commercial real estate lending. As such, the legislation does not eliminate the Agencies' ability to require banks to hold higher capital for HVCRE loans (150 percent). Rather, the bill provides the clarity which the Agencies have yet to provide, including which types of loans should and should not be classified as HVCRE loans.

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 (possibly away from the original lender).
- Clarify 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-compliant appraisal and thorough bank review.
- Excludes from application and compliance any loans made before January 1, 2015.

The legislation would clarify and modify the HVCRE rules to ensure that they are appropriately calibrated and do not impede credit capacity or economic activity, while still promoting economically responsible commercial real estate lending.

Of the $3.9 trillion in commercial real estate debt outstanding, commercial banks constitute our nation's largest source of commercial real estate financing. Yet, over $1 trillion is maturing though 2019 – including $469 billion in bank debt. Without adequate credit capacity, this wall of maturities could create problems in the banking system and the broader economy.

Since the Rule's effective date of January 1, 2015, necessary clarification for key elements of the Rule have not been provided by the Agencies despite ongoing requests. Instead, the Agencies issued a Notice of Proposed Rulemaking on Oct. 27, 2017[6] that fails to clarify the existing HVCRE definition which continues to be required from advanced standards banks – instead it creates a new exposure category.

The Agencies were aware that H.R. 2148 had nearly unanimous support in the House Financial Services Committee, yet they released the HVADC NPR under the guise of paperwork reduction act instead of responding to repeated requests for clarity. With the House passage of H.R. 2148, it is clear that the House of Representatives and its Financial Services Committee are telegraphing a very strong message to the regulators regarding the need to address and clarify industry concerns about the Basel III HVCRE rules.

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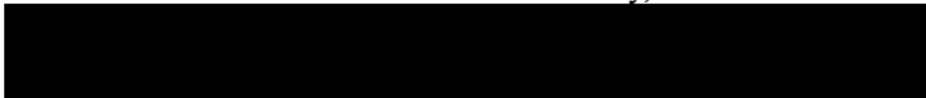
[6] October 27, 2017, Notice of Proposed Rulemaking, Basel III High Volatility Acquisition Development or Construction (HVADC), "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996"

We encourage the Agencies to review the language in *Clarifying High Volatility Commercial Real Estate Loans* (H.R. 2148)[7] and utilize such an approach to clarify the current HVCRE rules and build on this construct in a new consolidated HVCRE/HVADC rule.

We appreciate the opportunity to comment on this important proposed rule and welcome the opportunity to meet with the Agencies to expand on the views expressed in this letter. 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.

Sincerely,



Jeffrey D. DeBoer
President and Chief Executive Officer

Attachment

[7] A copy of H.R.2148 is attached to this comment letter.

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IIB

115TH CONGRESS
1ST SESSION

# H. R. 2148

IN THE SENATE OF THE UNITED STATES

NOVEMBER 8, 2017

Received; read twice and referred to the Committee on Banking, Housing, and Urban Affairs

# AN ACT

To amend the Federal Deposit Insurance Act to clarify capital requirements for certain acquisition, development, or construction loans.

1 *Be it enacted by the Senate and House of Representa-*

2 *tives of the United States of America in Congress assembled,*

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as ''Clarifying Commercial
3 Real Estate Loans''.

4 **SEC. 2. CAPITAL REQUIREMENTS FOR CERTAIN ACQUISI-**
5 **TION, DEVELOPMENT, OR CONSTRUCTION**
6 **LOANS.**

7 The Federal Deposit Insurance Act is amended by
8 adding at the end the following new section:

9 **''SEC. 51. CAPITAL REQUIREMENTS FOR CERTAIN ACQUISI-**
10 **TION, DEVELOPMENT, OR CONSTRUCTION**
11 **LOANS.**

12 ''(a) IN GENERAL.—The appropriate Federal bank-
13 ing agencies may only subject a depository institution to
14 higher capital standards with respect to a high volatility
15 commercial real estate (HVCRE) exposure (as such term
16 is defined under section 324.2 of title 12, Code of Federal
17 Regulations, as of October 11, 2017, or if a successor reg-
18 ulation is in effect as of the date of the enactment of this
19 section, such term or any successor term contained in such
20 successor regulation) if such exposure is an HVCRE ADC
21 loan.

22 ''(b) HVCRE ADC LOAN DEFINED.—For purposes
23 of this section and with respect to a depository institution,
24 the term 'HVCRE ADC loan'—

25 ''(1) means a credit facility secured by land or
26 improved real property that, prior to being reclassi-

1 fied by the depository institution as a Non-HVCRE
2 ADC loan pursuant to subsection (d)—
3 ''(A) primarily finances, has financed, or
4 refinances the acquisition, development, or con-
5 struction of real property;
6 ''(B) has the purpose of providing financ-
7 ing to acquire, develop, or improve such real
8 property into income-producing real property;
9 and
10 ''(C) is dependent upon future income or
11 sales proceeds from, or refinancing of, such real
12 property for the repayment of such credit facil-
13 ity;
14 ''(2) does not include a credit facility financ-
15 ing—
16 ''(A) the acquisition, development, or con-
17 struction of properties that are—
18 ''(i) one- to four-family residential
19 properties;
20 ''(ii) real property that would qualify
21 as an investment in community develop-
22 ment; or
23 ''(iii) agricultural land;
24 ''(B) the acquisition or refinance of exist-
25 ing income-producing real property secured by

1 a mortgage on such property, if the cash flow
2 being generated by the real property is suffi-
3 cient to support the debt service and expenses
4 of the real property, as determined by the de-
5 pository institution, in accordance with the in-
6 stitution's applicable loan underwriting criteria
7 for permanent financings;

8 ''(C) improvements to existing income-pro-
9 ducing improved real property secured by a
10 mortgage on such property, if the cash flow
11 being generated by the real property is suffi-
12 cient to support the debt service and expenses
13 of the real property, as determined by the de-
14 pository institution, in accordance with the in-
15 stitution's applicable loan underwriting criteria
16 for permanent financings; or

17 ''(D) commercial real property projects in
18 which—

19 ''(i) the loan-to-value ratio is less than
20 or equal to the applicable maximum super-
21 visory loan-to-value ratio as determined by
22 the appropriate Federal banking agency;
23 and

24 ''(ii) the borrower has contributed
25 capital of at least 15 percent of the real

1 property's appraised, 'as completed' value
2 to the project in the form of—
3 ''(I) cash;
4 ''(II) unencumbered readily mar-
5 ketable assets;
6 ''(III) paid development expenses
7 out-of-pocket; or
8 ''(IV) contributed real property
9 or improvements; and
10 ''(iii) the borrower contributed the
11 minimum amount of capital described
12 under clause (ii) before the depository in-
13 stitution advances funds under the credit
14 facility, and such minimum amount of cap-
15 ital contributed by the borrower is contrac-
16 tually required to remain in the project
17 until the credit facility has been reclassi-
18 fied by the depository institution as a Non-
19 HVCRE ADC loan under subsection (d);
20 ''(3) does not include any loan made prior to
21 January 1, 2015; and
22 ''(4) does not include a credit facility reclassi-
23 fied as a Non-HVCRE ADC loan under subsection
24 (d).

1 "(c) VALUE OF CONTRIBUTED REAL PROPERTY.—
2 For purposes of this section, the value of any real property
3 contributed by a borrower as a capital contribution shall
4 be the appraised value of the property as determined
5 under standards prescribed pursuant to section 1110 of
6 the Financial Institutions Reform, Recovery, and Enforce-
7 ment Act of 1989 (12 U.S.C. 3339), in connection with
8 the extension of the credit facility or loan to such bor-
9 rower.

10 "(d) RECLASSIFICATION AS A NON-HVCRE ADC
11 LOAN.—For purposes of this section and with respect to
12 a credit facility and a depository institution, upon—

13 "(1) the completion of the development or con-
14 struction of the real property being financed by the
15 credit facility; and

16 "(2) cash flow being generated by the real prop-
17 erty being sufficient to support the debt service and
18 expenses of the real property,

19 in either case to the satisfaction of the depository institu-
20 tion, in accordance with the institution's applicable loan
21 underwriting criteria for permanent financings, the credit

1 facility may be reclassified by the depository institution
2 as a Non-HVCRE ADC loan.''.

Passed the House of Representatives November 7, 2017.

Attest: KAREN L. HAAS,

*Clerk.*