MORTGAGE BANKERS ASSOCIATION

March 21, 2016

Anna Lee Hewko
Associate Director
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Amrit Sekhon
Deputy Comptroller for Capital and
Regulatory Policy
Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Ryan Billingsley
Chief, Capital Policy Section
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Basel III HVCRE Final Rule: Meeting Request for April 12, 2016 and Summary of HVCRE Concerns

Dear Ms. Hewko, Mr. Billingsley and Mr. Sekhon:

Over the past year, the Mortgage Bankers Association[1] (MBA) has been working with representatives from the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency (collectively, the Agencies) to obtain important clarifications to the portion of the Basel III final rule[2] that involves High Volatility Commercial Real Estate[3] (HVCRE final rule). This letter is intended to supplement MBA's prior submittals during this timeframe that include two comment letters and three HVCRE analytical papers.

---

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] 78 Fed. Reg. 62018 (October 11, 2013).

[3] 78 Fed. Reg. 62165.

MBA members continue to report that a number of components of the HVCRE final rule have had detrimental impacts on both ADC loan deal terms and loan decisions. As the largest source of acquisition, development and construction (ADC) loans, banks that engage in this lending have been negatively impacted by the lack of clarity.

Consequently, MBA remains concerned that nearly a year after the Agencies published "Frequently Asked Questions on the Regulatory Capital Rule"[4] (FAQ), they have not provided additional guidance or proposed rule changes to address significant issues and concerns regarding the HVCRE final rule. Unfortunately, the FAQ did not clarify many of the problematic elements of the HVCRE final rule. Given this lack of regulatory clarity, MBA noted in its analysis of Call Report HVCRE data, there was a wide disparity in how banks were electing to classify their construction loans for HVCRE purposes.[5]

Since the last in-person meeting with Agency representatives in 2015, MBA has worked closely with them to provide supplemental information and analysis, and our bank members continue to be challenged by HVCRE final rule implementation issues. With over a year of operational experience with the HVCRE final rule in place, we would greatly appreciate the opportunity to meet with Agency staff to discuss the ongoing negative impacts of the HVCRE final rule. In addition to this letter, MBA contacted agency staff via e-mail to request a meeting on April 12, 2016. Below, we summarize three of our major, but not all, of our concerns with the HVCRE final rule.

<u>Prohibition on the Withdrawal of Internally Generated Capital</u>

Under a certain reading of the HVCRE final rule, even after the 15 percent capital contribution is met, there would be a prohibition of withdrawing from the project internally generated capital. The ongoing retention requirement for internally generated capital could result in capital in excess of 15 percent being retained within the project. Instead of requiring all internally generated capital to be retained in the project for the life of the ADC loan, we recommend distributions of internally generated capital be permitted as long as the original 15 percent capital contribution is maintained for the life of the ADC loan. The 15 percent capital contribution requirement at the inception of funding represents significant and sufficient skin in the game. MBA is concerned that additional capital retention requirements could have adverse operational impacts during the construction phase of the project.

---

[4] Office of the Comptroller of the Currency. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Frequently Asked Questions on the Regulatory Capital Rule, March 31, 2015.

[5] MBA, HVCRE Results for First Quarter Call Reports for Banks with Over $1 Billion of Acquisition, Construction and Development (ADC) Loans, June 2015.

In order to be compliant with the HVCRE final rule, banks are required in their loan documents to eliminate and enforce the ability of the borrower to utilize internally generated capital. Such a blunt instrument would prohibit banks from negotiating contract terms that would be beneficial to the bank and borrower if it involved the distribution of internally generated capital. This could imperil a bank's long standing relationships with responsible borrowers. At a minimum, we would strongly urge the Agencies to more precisely define internally generated capital and provide a description for the uses of internally generated capital that are permitted within the HVCRE final rule. These should include but are not limited to: interest payments, principal payments, development fees, and other ongoing development fees and expenses.

Reclassification of an ADC loan from HVCRE to Income Producing Real Estate Status

The HVCRE final rule allows for a bank to provide permanent financing for a HVCRE loan provided that the "permanent financing is subject to the same [Bank]'s underwriting criteria for long-term mortgage loans[6]". The Agencies should specify that at such time when the HVCRE loan, including extension options, meets the same underwriting criteria (stabilized cash flow, lease-up completed, etc.) that a bank follows to provide permanent financing, the loan can be reclassified from HVCRE to income producing real estate in order to remove the HVCRE capital requirement. Unfortunately in the Call Report[7], we have observed an instance when the HVCRE exposure was greater than a bank's ADC loan book. This indicates that loans that had been taken off a bank's ADC loan book had to be classified as HVCRE loans because they did not meet the strict requirement for HVCRE loan reclassification.[8]

Appreciated Land Value

Given the potential vast differences in a developer's basis (purchase price and improvement costs) and fair market value for the land that comprises an ADC loan, we strongly recommend that a bank be permitted to recognize appreciated land value as part of the 15 percent equity requirement. It seems an unfair result not to recognize appreciated land value as part of the 15 percent capital contribution requirement, particularly if the land has been held for a substantial period of time and has significantly escalated in value. With the appropriated safeguards such as a FIRREA-compliant appraisal and thorough bank review, the Agencies should allow for the appreciated value of the property to be included in the 15 percent equity contribution requirement. In order to account for value fluctuations, MBA would support a reasonable "haircut" for the appraised value that would be determined by the Agencies. This would avoid the developer having to monetize the appreciated value with a third party in order to use the proceeds towards the 15 percent contributed capital requirement. It is important to note as

---

[6] Fed. Reg. Vol. 78, p. 62165 (October 11, 2013).

[7] Data from First Quarter 2015 Call Report.

[8] HVCRE status concludes only when the credit facility is converted to permanent financing or is sold or paid in full.

support for inclusion of the appreciated land value that the market value of the land is part of the "as-completed" value in an appraisal.

* * *

MBA appreciates the open dialogue that the Agencies have provided on this important matter. We look forward to continuing this vital interaction. Any questions regarding this letter or meeting request should be addressed to George Green, Associate Vice President, at ggreen@mba.org or (202) 557-2840.

Sincerely,

David H. Stevens, CMB
President and Chief Executive Officer