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MORTGAGE BANKERS ASSOCIATION

November 27, 2018

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC–2018-0268; RIN 1557-AE48

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue NW
Washington, DC 20551
Regulation Q; Docket No. R-151621; RIN 7100 AF-15

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
550 17th Street NW
Washington, DC 20429
RIN 3064-AE90

Re: Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures[1]

The Mortgage Bankers Association (MBA)[2] respectfully submits these comments on the Notice of Proposed Rulemaking issued by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System (collectively "the Agencies"), proposing to amend the High Volatility Commercial Real Estate (HVCRE) risk-based capital rule to implement section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).

The EGRRCPA was enacted May 24, 2018. Under section 214 of EGRRCPA, the appropriate federal banking agencies may only require a depository institution to assign a heightened risk weight to an HVCRE exposure if it is an HVCRE ADC loan as defined in that section. MBA supported this legislative change, and we hope our comments help the Agencies implement the legislation in a way that provides the clarity and relief that Congress intended in a manner

[1] 83 Fed. Reg. 48990 (Sept. 28, 2018).

[2] 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 to 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 2,300 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.mba.org.

consistent with the principles of risk-based capital. In this regard, we applaud the flexibility the Agencies have already shown in their interagency statement,[3] which provided interim guidance on reporting under the legislation, which was necessary because the legislation became effective immediately when enacted.

I. EXECUTIVE SUMMARY

We appreciate that the proposal adopts the operative language from the legislation. Accordingly, we have no comments or suggestions as to the text of the proposed revised HVCRE rule.

We do provide comments and suggestions, however, on some of questions the proposal raises on implementation and interpretation issues. Most significantly, we have concerns that the proposed treatment of loans secured by vacant non-agricultural land and the treatment of loans secured by one- to four-family residential condominium property could cause unnecessary confusion because they would be inconsistent with the legislation in some cases. We also recommend that the Agencies allow for flexibility in the interpretation of "primarily finances," that the Agencies make reevaluation of HVCRE loans from 2015 and after, optional at the discretion of each financial institution, and that the Agencies clarify appraisal requirements in connection with multi-phase projects. We also urge the Agencies to suspend existing 2015 FAQs issued under the current HVCRE rule and generally to formalize any relevant interpretations and guidance as to the revised HVCRE rule through a notice-and-comment process.

MBA and its bank members have engaged with the Agencies over the years on the effective implementation of the HVCRE rule, and we look forward to continuing to work together toward successful implementation of this legislative change.

II. BACKGROUND

The banking agencies issued their HVCRE rule in 2013 as part of its Basel III.[4] The rule specified the types of acquisition, development or construction (ADC) credit facilities that must be classified HVCRE exposures subject to a 150 percent risk weight. The rule became effective January 1, 2015. In response to numerous questions and concerns raised by MBA and others regarding how to apply the HVCRE rule, the Agencies issued a set of joint FAQs in April 2015.[5]

The HVCRE rule subsequently fell within the scope of a review the Agencies conducted under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA),[6] which sought to identify outdated, unnecessary or unduly burdensome regulatory requirements. As an outgrowth

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[3] *Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)* (jointly issued by the Bd. of Gov. FRS, FDIC, OCC), 2-3 (July 6, 2018). Available at: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf

[4] 78 Fed. Reg. 62018 (Oct. 11, 2013).

[5] *Frequently Asked Questions on Regulatory Capital Rule* (jointly issued by the OCC, Bd. of Gov. FRS, FDIC (April 6, 2015). Available at: https://www.federalreserve.gov/supervisionreg/srletters/sr1506a1.pdf

[6] 12 U.S.C. § 3311.

of that process and its resulting 2017 report,[7] the Agencies proposed in 2017 to replace the HVCRE rule (for standardized approach institutions only) with a High Volatility Acquisition, Development or Construction (HVADC) Rule.[8] MBA and others commented that the proposal would not address the concerns raised by financial institutions.

Separately, Congress sought to address those concerns legislatively, an effort MBA supported. The resulting legislation, the EGRRCPA, was enacted on May 24, 2018. Effective immediately, section 214 of EGRRCPA superseded contrary provisions of the current HVCRE rule.

Recognizing this fact, the Agencies issued an interagency statement July 6, 2018, providing interim guidance on how to report HVCRE exposures under the legislative change, pending the completion of a rulemaking to conform the current HVCRE rule to section 214 of EGRRCPA.[9] This rulemaking implements section 214 by making such conforming amendments to the current HVCRE rule.

III. COMMENTS

a. Loans secured by vacant land

In Question 2 of the proposal, the Agencies request comment on whether loans secured by vacant land except agricultural land should be included in the scope of the revised HVCRE exposure definition. The rationale for doing so would be to align the interpretation with call report instructions on reporting of other land loans with construction and development loans.[10]

While we appreciate the value of aligning terms here with call report instructions, the proposed interpretation here would create unnecessary confusion because, applied to some circumstances, it would be directly contrary to the language of the proposed regulation and the underlying legislation. Specifically, the proposed interpretation would effectively eliminate all but the first six words of the amended definition of “High volatility commercial real estate (HVCRE) exposure,” effectively eliminating three key elements of the definition, as is illustrated below:

> *High volatility commercial real estate (HVCRE) exposure* means:
> (1) A credit facility secured by land … ~~that, prior to being reclassified by the [financial institution] as a non-HVCRE exposure pursuant to paragraph (6) of this definition—~~
> ~~(i) Primarily finances, has financed, or refinances the acquisition, development, or construction of real property;~~

[7] Federal Financial Institutions Examination Council, *Joint Report to Congress; Economic Growth and Regulatory Paperwork Reduction Act* (jointly issued by the Bd. of Gov. of the FRS, OCC, FDIC and NCUA) (March 2017). Available at: https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf

[8] 82 Fed. Reg. 49984 (Oct. 27, 2017).

[9] *Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),* 2-3.

[10] 83 Fed. Reg. at 48993.

> ~~(ii) Has the purpose of providing financing to acquire, develop, or improve such real property into income producing real property; and~~
> ~~(iii) Is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility; provided that: ….~~

While this may have no practical impact on some loans secured by non-agricultural land, this is not the case for all such loans. That is, in some cases, loans secured by non-agricultural vacant land may **not** primarily finance ADC activities; may **not** be for the purpose of acquiring, developing or improving the property into income producing real property; and/or may **not** depend on future income, sales proceeds from, or refinancing of the land for repayment. Similarly, in some cases, loans secured by non-agricultural vacant land may meet the institution's underwriting standards for permanent financing. For those loans, the proposed interpretation would not accurately apply all of the terms of the legislation.

To prevent confusion and the possible misapplication of the legislation to such loans, we recommend that the Agencies make no categorical application of the HVCRE rule to loans secured by non-agricultural vacant land. Rather, the treatment of loans secured by non-agricultural land should be determined by direct application of all of the terms of the legislation, under the revised HVCRE rule.

b. Condominiums

The Agencies propose to align their interpretation of "one-to-four family residential properties" with *Interagency Guidelines For Real Estate Lending Policies*,[11] as follows:

> loans to finance the construction of condominiums and cooperatives would generally not be included in the scope of the one- to four-family residential properties exclusion under the revised HVCRE exposure definition.[12]

While the use of the term "generally" in the proposed interpretation appears to allow for the possibility of exceptions, we believe that the proposed interpretation as a whole is likely to cause confusion because in some cases it would not also be aligned with the legislation. The legislation exempts credit facilities secured by "one- to-four family residential properties." The fact that units of a one- to-four family residential property are in form condominium units rather than rental or owner-occupied units does not change the number of units specified in the exemption. Similarly, it does not change the fundamental nature of the property from being residential – people will reside in the residential units of the property. As a result, the proposed interpretation would be inconsistent with the legislation if applied to loans one- to four-unit residential condominium properties.

To clearly conform the interpretation to the legislation, we recommend that the Agencies interpret the scope of the one- to four-family residential property" exemption in a manner that does not

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[11] *See Interagency Guidelines For Real Estate Lending Policies* (real estate lending standards), 12 C.F.R. part 208 Appendix C (Board); 12 C.F.R. part 34 Appendix A (OCC); 12 C.F.R. part 365 Appendix A (FDIC) (in all cases, footnote 1 to table of supervisory LTV limits: "Multifamily construction includes condominiums and cooperatives").

[12] 83 Fed. Reg. at 48993.

distinguish between one- to four-family properties where the units are rentals, owner-occupied, condominiums or cooperatives. This could be accomplished by aligning the interpretation with call report instructions, under which one- to four-unit condominium residential properties are reported as loans secured by one- to four-family residential properties in the same way as one- to-four family residential rental or owner-occupied properties.[13]

While the Agencies initially rejected aligning their interpretation with call report instructions because of the differences in underlying purposes,[14] the call report instructions align with the legislative text in a way the footnote in the interagency lending standards does not.

If the Agencies do not accept this recommendation and instead adopt this interpretation as proposed, they should make conforming revisions to call report and FR Y-9C instructions for loans financing construction of condominiums, so an institution would report consistent populations of HVCRE exposures in its FFIEC 101, call report and FR Y-9C.

c. "Primarily finances"

In Question 2 of the proposal, the Agencies request comment on whether the term ‘‘primarily finances’’ is clear or whether further discussion or interpretation would be needed.

While not mentioned in the proposal, we note that the term "primarily finances" is identical to language used in the Agencies' 2017 HVADC proposal. In that rulemaking proposal, the Agencies proposed that a credit facility "primarily finances" the acquisition, development or construction of real property if more than 50 percent of the proposed use of funds (e.g., loan proceeds) was for acquisition, development, or construction activities.[15]

We agree with the Agencies' approach of not proposing that interpretation here. While the 50 percent threshold may be appropriate in some cases, there may also be instances where, depending on the particular facts and circumstances, a credit facility may not "primarily finance" the acquisition, development or construction of real property, even where more than 50 percent of proposed use of funds is for ADC activities. As a result, that application of a 50 percent threshold could conflict with the legislation.

Therefore, we recommend that the Agencies not issue a clarifying interpretation of "primarily finances." Alternatively, to the extent the Agencies determine to provide guidance, we suggest the Agencies expressly permit institutions to employ reasonable approaches to interpreting "primarily finances" appropriate to the facts and circumstances and that such guidance identify the 50 percent threshold only as a permissible method of determining whether a credit facility does not "primarily finance" ADC activities.

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[13] See FFIEC, *Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 031 and, 041),* Schedule RC-C, part I, line item 1.c.(1).

[14] 83 Fed. Reg. at 48993, note 19.

[15] Id. at 49988. We note that other elements of the 2017 discussion of the meaning of "primarily finances" are inapplicable under the legislation and revised HVCRE rule. For example, while an ADC exposure not secured by real estate might be classified as HVADC under the 2017 proposal, it could not be classified HVCRE under the legislation or the revised HVCRE rule.

d. Reevaluation of ADC loans originated on or after January 1, 2015

In Question 1 of the proposal, the Agencies invite comment on whether the final rule should require reevaluation of ADC loans originated on or after January 1, 2015, under the revised HVCRE exposure definition.

The legislation narrows the scope of ADC loans subject to the higher, 150 percent risk weight. Therefore, no 2015 or later ADC loan that was not HVCRE under the existing rule can become HVCRE under the revised rule. Similarly, reevaluation of ADC loans classified as HVCRE under the current rule would result only in determinations that the loans either remain HVCRE under the revised rule or become non-HVCRE.

Because the impact of the legislation and revised HVCRE rule on 2015 or later ADC loans would be capital neutral or would provide capital relief, there appears to be no supervisory imperative to require reevaluations. Therefore, we recommend that reevaluations be optional, at the sole discretion of each institution. Each institution should be able to make its own determination as to whether the capital relief that might result from a reevaluation would justify the level of effort required to conduct the necessary reevaluation. This approach would be consistent with the flexibility afforded under the Agencies' July 2018 interagency statement regarding the impact of EGRRCPA.

e. Phased projects and appraisals

Under the proposed revised HVCRE rule, an ADC loan is not classified as an HVCRE exposure if, among other requirements, "[t]he borrower has contributed capital of at least 15 percent of the real property's appraised, 'as completed' value to the project …."[16]

The Agencies recognize that this element of the HVCRE rule may be applied to multi-phase projects and proposes to provide the following guidance:

> The agencies are proposing that in the case of a project with multiple phases or stages, in order for a loan financing a phase or stage to be eligible for the contributed capital exclusion, the phase or stage must have its own appraised ''as completed'' value or an appropriate evaluation in order for it to be deemed a separate ''project'' for purposes of the 15 percent capital contribution calculation.[17]

This statement confirms a permissible approach lenders may use to apply this provision of the HVCRE rule to an individual phase of a project. By separating the project into phases, the statement confirms that the lender can meet the 15 percent contribution requirement by reference to an "as completed" value for a phase as opposed to the entire project.

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[16] Section (2)(iv)(B) of the proposed definition of *High volatility commercial real estate (HVCRE) exposure* (this element of the proposed rule is materially the same for these purposes as the current HVCRE rule).

[17] 83 Fed. Reg. at 48995.

That statement appears to be a particular application of the general principle that the "as completed" appraisals a lender relies on to apply the 15 percent minimum contribution should be appropriate for the nature of each particular credit facility and project (as well as with applicable supervisory requirements for appraisals). Under that same general principle, where a lender is lending for an entire project, it is our understanding that neither the HVCRE rule nor the statement above would require individual phase-level appraisals or valuations. Rather, the lender could rely for its HVCRE analysis on an "as completed" value for the entire project. We request that the Agencies clarify that this is the case.

f. Interpretations and FAQs

In Question 11 of the proposal, the Agencies ask about they should issue interpretations of the rule. As a general matter, we recommend that the Agencies formalize interpretations only through a notice-and-comment process. As is illustrated in this case, the notice-and-comment process helps mitigate the risk that Agency interpretations may not take into account the full range of circumstances to which it might apply.

In addition, as a housekeeping matter, we note that the Agencies' 2015 FAQs remain in place. Because those FAQs do not correspond to the revised rule (or the legislation), we urge the Agencies to suspend those FAQs and, to the extent the Agencies determine to formalize that or other guidance and interpretations of the revised HVCRE rule, we recommend doing so following a notice and comment process.

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MBA appreciates the Agencies' combined efforts and flexibility implementing this legislative change to its risk-based capital rules, and the opportunity to comment on the proposed revised HVCRE rule and possible interpretations. We recognize that this is a substantial endeavor, and MBA and its members look forward to working with the Agencies to make this implementation a success.

For additional information or any questions about these comments, please do not hesitate to contact Bruce Oliver, Associate Vice President, Commercial/Multifamily Policy, at 202-557-2840 or boliver@mba.org.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association