



January 26, 2015

Honorable Janet L. Yellen
Chair
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
12 CFR Parts 208, 217, and 225

Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
12 CFR Parts 3, 5, 6, et al.

Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Basel III HVCRE Final Rule: Request for Clarification

Ladies and Gentlemen:

The Mortgage Bankers Association¹ (MBA) appreciates the opportunity to provide supplemental comments to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency (collectively, the Agencies) regarding the portion of the Basel III final rule² that involves High Volatility Commercial Real Estate (HVCRE)³. Presented herein are MBA's views on areas of the final HVCRE rule (Basel III HVCRE Rule) that require greater clarification. Under the Basel III HVCRE Rule, acquisition,

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.

construction, and development (ADC) loans that don't meet certain underwriting criteria⁴ are required to be classified as HVCRE exposures. For HVCRE exposures, the risk weight is 150 percent (as opposed to 100 percent risk weight for commercial and industrial loans), resulting in higher capital. The Basel III HVCRE Rule became effective on January 1, 2015.

For risk-based capital reporting purposes, banks will be required to determine the HVCRE status for each of their ADC loans for the first quarter reporting period (March 31, 2015). In order to meet this deadline, banks are in the process of modifying their regulatory reporting systems to reflect the new HVCRE reporting requirement. Given this rapidly approaching deadline, MBA members have strongly indicated that greater clarity for the Basel III HVCRE Rule is necessary for them to correctly modify their regulatory reporting systems to evaluate the HVCRE status for each loan in their ADC portfolio. MBA has worked closely with our bank members to identify a number of issue areas in which we seek the Agencies' confirmation. These include:

1. The 15 Percent Equity Requirement Measured Under the Basel III HVCRE Rule:

- The 15 percent equity requirement is measured at loan closing, based on a timely FIRREA compliant appraisal of the "as-completed" value of the project.
- The following scenarios also meet the 15 percent equity requirement:
 - Measured at loan closing with no funding if loan documentation requires 15 percent borrower equity to be invested into the project prior to any funding by bank.
 - Measured at loan closing of senior credit facility which closes simultaneously with subordinated debt or preferred equity issuance if senior lender has no funding obligation until the 15 percent borrower equity has been invested into the project.
- After a bank's initial advance, a borrower may be given a short cure period to contribute additional capital if there is a breach of the ongoing 15 percent equity requirement.

2. Unencumbered Readily Marketable Assets/Sources of 15 Percent Contributed Capital Include:

- A bank can recognize the deposit of cash or unencumbered readily marketable securities in bank controlled account as part of the 15 percent equity requirement.
- A bank can recognize cash paid to acquire raw land as part of the 15 percent equity requirement.

⁴ This includes but is not limited to: (1) loan to value ratio of less than 80 percent and (2) contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at less than 15 percent of the real estate's appraised "as completed" value.

- A bank can recognize appreciated land value as part of the 15 percent equity requirement.⁵
- A bank can recognize a standby letter of credit, immediately drawable for development expenses (with no other draw conditions), as part of the 15 percent equity requirement.
- A bank can recognize preferred equity as part of the 15 percent equity requirement.
- A bank can recognize mezzanine and subordinated debt financing provided by a third party as part of the 15 percent equity requirement.
- A borrower can satisfy the 15 percent equity requirement throughout the life of the construction loan by a combination of original contributed equity and capital internally generated by the project. The 15 percent equity requirement must be met before the bank funds under its loan.
- A bank will need to be able to evidence that the funds had been invested in the project. A bank can accept paid project invoices evidencing payment of out-of-pocket development expenses to count towards the 15 percent equity requirement. A segregated disbursement account would not be required for payment of development expenses.

3. Reclassification of HVCRE to Non-HVCRE:

- A bank can treat an HVCRE loan (i.e., construction loan) with a fixed term for construction and extension period(s) available only upon stabilization with sufficient cash flow to service debt and required amortization and no longer dependent on the sale of the property for repayment during such extension periods as “permanent financing” under the Basel III HVCRE Rule.
- A bank can treat an interest only loan supported by a cash flow test based on hypothetical amortization and other criteria consistent with bank’s customary underwriting standards.

4. Permitted Withdrawals:

- Disbursement of developer fees to borrower or borrower affiliate after loan closing does not constitute a return of capital in violation of the Basel III HVCRE Rule, provided that the amount of contributed capital remains at 15 percent of the as-completed value.
- A bank can permit borrower withdrawals based on any excess over 15 percent (measured against the “as completed” value at loan inception) of the sum of contributed equity and internally generated capital.

⁵ It seems a punitive result not to recognize appreciated land value as part of the 15 percent requirement, particularly, if the land has been held for a substantial period of time. A developer could conceivably monetize the appreciated value with a third party and then use the cash to contribute to the project and count against the 15 percent equity requirement. It is important to note as 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.

- A bank can allow payment of preferred equity return (i) during construction including by means of a built-in interest reserve in senior construction financing with customary provisions such as senior lender has no future funding obligations upon a loan default and (ii) after stabilization, subject to borrower's continued compliance with the 15 percent equity requirement.

5. Credit Facilities should be Characterized as HVCRE Exposure if they Meet the HVCRE Criteria:

- Direct purchase bonds secured by real estate in which the bank owns the bonds and the exposure is booked on the bank's balance sheet as a loan.
- Direct pay letters of credit/credit enhancements secured by real estate and issued in support of a bond for purposes of financing acquisition, development or construction of real estate.
- Standby or commercial letters of credit secured by real estate and issued in support of financing acquisition, development or construction of real estate
- Standby (bond) purchase agreements secured by real estate and issued in support of financing acquisition, development or construction of real estate.

6. Repo Loan Facilities and Loan Facilities Secured by HVCRE Loans:

- A bank can recognize a significant discount with the counterparty in long-term REPO facilities and Loan on Loan facilities secured by HVCRE loans as part of the 15 percent equity requirement.

MBA greatly appreciates the opportunity to highlight the areas of the Basel III HVCRE Rule that require additional clarification. In addition, MBA will be contacting the Agencies to arrange a meeting to discuss our concerns. Finally, MBA will be seeking the Agencies' guidance on the topics raised herein to be addressed in the appropriate forum, for example, "Frequently Asked Questions" are often prepared to address implementation issues for regulations. Any questions regarding this letter should be addressed to George Green, Associate Vice President, at ggreen@mba.org or (202) 557-2840.

Sincerely,



David H. Stevens

President and Chief Executive Officer