MORTGAGE BANKERS ASSOCIATION

August 22, 2019

Office of the Comptroller of the Currency
Chief Counsel's Office
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC–2018–0026; 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-11669; RIN 7100 AF-53

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
550 17th Street NW
Washington, DC 20429
RIN 3064-AF06

Re: July 2019 Proposal on Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures[1]

Dear Ladies and Gentlemen:

The Mortgage Bankers Association (MBA)[2] respectfully submits these comments on the second Notice of Proposed Rulemaking (2019 Proposal) 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 a HVCRE Acquisition, Development and Construction (ADC) loan as defined in that section. MBA supported this legislative change, and we hope our

[1] 84 Fed. Reg. 35344 (July 26, 2019).

[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, DC, 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 website: www.mba.org.

comments help the Agencies implement the legislation in a way that provides the clarity and operational relief that Congress intended in a manner consistent with the principles of risk-based capital.

Following passage of EGRRCPA, the Agencies released an interagency statement on July 6, 2018[3] providing guidance to banking organizations on how they may determine the risk-based capital treatment pending the issuance of final regulations implementing section 214, and the Agencies initiated the process of amending their HVCRE rules to conform them to section 214 by issuing a notice of proposed rulemaking (2018 Proposal).[4] MBA submitted comments to the 2018 Proposal on November 27, 2018.

The Proposal

The 2019 Proposal expands on the 2018 Proposal by adding a new subsection specifying the treatment of land development loans under the one- to four-family residential property exemption of the revised definition of HVCRE exposure. Specifically, the Proposal would add a new subsection (7) to the definition of HVCRE exposure:

> For purposes of this definition, credit facilities that do not finance the construction of one- to four-family residential structures, but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, do not qualify for the one- to four-family residential properties exclusion in paragraph 2(i)(A).

This appears to be a narrowing of the scope of the one- to four-family residential exemption as it was described in the preamble to the 2018 Proposal:

> [T]he agencies are proposing that credit facilities for the purpose of the acquisition, development, or construction of properties that are one- to four-family residential properties would include both loans to construct one- to four-family residential structures and loans that combine the land acquisition, development, or construction of one- to four-family structures, <u>including lot development loans</u>.[5]

While we recognize that the Agencies have proposed this narrowing of the scope of the one- to four-family residential property exemption based on considerations of risk, we urge the Agencies also to consider the extent to which such a narrowing of the exemption might result in undue barriers to the development of new housing, including affordable housing.[6]

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

[5] Id. at 48993 (emphasis added).

[6] See *Executive Order Establishing a White House Council on Eliminating Regulatory Barriers to Affordable Housing* (June 25, 2019); https://www.whitehouse.gov/presidential-actions/executive-order-establishing-white-house-council-eliminating-regulatory-barriers-affordable-housing/

HVCRE and "Other Land Loans"

The 2019 Proposal includes the statement on the application of the revised HVCRE definition to "other land loans" in light of the proposed treatment of land development loans under the one- to four-family residential property exemption:

> Consistent with the HVCRE NPR, the proposal would maintain that ''other land loans'' (generally loans secured by vacant land, except for land known to be used for agricultural purposes) would continue to be included within the scope of the revised HVCRE exposure definition.[7]

This 2019 statement appears to reference the following 2018 statement from the preamble to the 2018 proposal with respect to land loans, which was also in the context of a discussion of the one- to four-family residential property exemption:

> In addition, the agencies' propose to interpret that other land loans (generally loans secured by vacant land except land known to be used for agricultural purposes) would be included in the scope of the revised HVCRE exposure definition. This approach would be consistent with the Call Report's inclusion of other land loans with construction and development loans.[8]

In our comments of November 27, 2018 (copy attached and incorporated by reference herein), MBA commented on the 2018 statement. Specifically, we observed that the interpretation expressed in the 2018 statement was inconsistent with the proposed revised definition of HVCRE exposure and with section 214. The interpretation expressed in the 2019 statement is similarly inconsistent with the proposed revised definition of HVCRE exposure and with section 214.

That is, read literally, both statements suggest that land loans would fall within the definition of HVCRE exposure – without regard to whether they satisfy the actual elements of the definition as proposed or as specified in section 214. For example, both statements suggest that a loan secured by vacant land that does not satisfy the elements of subsection (1) of the revised definition of HVCRE exposure would still fall within that definition.

This would not be a reasonable interpretation of section 214 or of the proposed revised definition of HVCRE exposure. While many land loans that fall outside of the scope of the one- to four-family residential property exemption may fall within the definition of HVCRE, this will not be the case for all other land loans. Accordingly, guidance that suggests otherwise will create confusion for affected institutions and supervisory staff.

To provide clarity, and to reflect that some land loans that do not qualify for the one- to four-family exemption may nevertheless not be HVCRE exposures because they do not meet all three prongs of the revised definition of HVCRE, we suggest that the Agencies clarify the above statement in the preamble to a final rule, to the effect of:

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[7] 84 Fed. Reg. at 35346.

[8] 83 Fed. Reg. at 48993.

> Under new subsection (7), ''other land loans'' (generally loans secured by vacant land, except for land known to be used for agricultural purposes) would be included within the scope of the revised HVCRE exposure definition <u>only in cases where such loans otherwise meet all of the elements of subsection (1) the definition and are not eligible for any of the other exemptions specified in subsection (2).</u>

Because the statements on "other land loans" were included in both the 2018 and 2019 Proposals, we believe it is critical that the final rule explicitly clarify that the treatment of "other land loans" will be determined solely by direct application of the provisions of the rule.

* * *

We appreciate the Agencies' efforts to implement Section 214 of EGRRCPA, and to provide guidance to affected institutions as to how to proceed until that process can be completed. In that way, the Agencies are helping to ensure that banking organizations can realize the clarity and operational relief that Congress intended to provide in Section 214 of EGRRCPA.

Sincerely,

Pete Mills
Senior Vice President
Residential Policy and Member Engagement
Mortgage Bankers Association

Thomas T. Kim
Senior Vice President
Commercial Real Estate Finance
Mortgage Bankers Association

Attachment:

- MBA comment on Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures (Nov. 27, 2018).

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[9]

The Mortgage Bankers Association (MBA)[10] 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

[9] 83 Fed. Reg. 48990 (Sept. 28, 2018).

[10] 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.

legislation in a way that provides the clarity and relief that Congress intended in a manner consistent with the principles of risk-based capital. In this regard, we applaud the flexibility the Agencies have already shown in their interagency statement,[11] 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.[12] 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.[13]

The HVCRE rule subsequently fell within the scope of a review the Agencies conducted under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA),[14] which sought to identify outdated, unnecessary or unduly burdensome regulatory requirements. As an outgrowth

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[11] *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

[12] 78 Fed. Reg. 62018 (Oct. 11, 2013).

[13] *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

[14] 12 U.S.C. § 3311.

of that process and its resulting 2017 report,[15] 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.[16] 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.[17] 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.[18]

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;~~

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[15] 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

[16] 82 Fed. Reg. 49984 (Oct. 27, 2017).

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

[18] 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 <u>all</u> 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*,[19] 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.[20]

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 <u>does not change the number of units</u> specified in the exemption. Similarly, it does not change the fundamental nature of the property from being <u>residential</u> – people will <u>reside</u> 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

[19] *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").

[20] 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.[21]

While the Agencies initially rejected aligning their interpretation with call report instructions because of the differences in underlying purposes,[22] 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.[23]

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

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[21] 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).

[22] 83 Fed. Reg. at 48993, note 19.

[23] 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.

the 50 percent threshold only as a permissible method of determining whether a credit facility does not "primarily finance" ADC activities.

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 …."[24]

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.[25]

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

[24] 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).

[25] 83 Fed. Reg. at 48995.

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.

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.

* * *

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 CEO
Mortgage Bankers Association