

October 30, 2013

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

U.S. Department of the Treasury
250 E Street, SW
Washington, DC 20219

Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Subject: *Real Estate and Financial Services Organizations' Letter on Commercial/Multifamily
Mortgage Finance Re:*

Proposed Rule (Release Nos. 34-70277), Credit Risk Retention - Federal Reserve Docket
No. R-1411; FDIC RIN 3064-AD74; OCC Docket Number OCC-2013-0010; SEC File
Number S7-14-11; FHFA RIN 2590-AA43

Ladies and Gentlemen:

The undersigned organizations (“the Signatories”) welcome the opportunity to provide the collective insights of the real estate and finance industries regarding the commercial real estate elements of the re-proposed rule on credit risk retention (“the Re-proposal”). This letter responds to the Agencies¹ jointly released notice of proposed rulemaking to implement section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.² The Re-proposal follows the proposed rule issued in April 2011.³

The Signatories collectively and individually represent varied constituencies and have endeavored to submit recommendations balancing the needs and interests of all parties. The Signatories have all coalesced around a number of key features of the Re-proposal, in which specific recommendations and solutions are addressed in their individual comment letters.

¹ Agencies include: Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (the Fed), Federal Deposit Insurance Corporation (FDIC), Securities and Exchange Commission (SEC), Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development (HUD).

² Public Law 111-203, 124 Stat. 1376-2223 (July 21, 2010).

³ 76 Fed. Reg. 24090 (April 29, 2011).

Collectively, they emphasize the importance of commercial and multifamily real estate as an asset class. On an individual basis, the organizations collaborating on this letter agree that their objectives are harmonious and seek similar outcomes for the topics addressed in this letter.

The Signatories recognize that the Re-proposal reflects changes from the prior proposal that are beneficial to the CMBS market that include: the withdrawal of the Premium Capture Cash Reserve Account; enhanced flexibility regarding the allocation of risk retention between risk retention holders; and, including REITs in the definition of commercial real estate loans. The Signatories' most critical issues and corresponding recommendations are outlined below.

INDUSTRY'S OVERALL ASSESSMENT OF THE RISK RETENTION RE-PROPOSAL

In general, key participants in the CMBS industry ("the Industry") believe that the basic retention regime outlined in the Re-proposal, with certain modifications, can be the basis for a viable set of retention rules. We recognize that an extraordinary amount of thought and work went into the development of the Re-proposal, and we particularly appreciate the Agencies' efforts to craft provisions that seek to address the unique characteristics of the CMBS market.

In promulgating the re-proposal, the Agencies made clear that they are attempting "to minimize the potential for the proposed rule to negatively affect the availability and costs of credit to consumers and businesses."⁴ The CMBS retention rules – not taking into consideration any proposed cash flow tests – appear to impose a cost on borrowers that is projected to be from 40 to 50 basis points for conduit transactions.⁵ This marginal cost translates into an increased burden on commercial property owners of 10.0 to 12.5 percent at current market borrowing rates of approximately 5 percent. Given that CMBS lenders compete with lending sources that may not securitize and therefore are not subject to risk retention, we strongly urge the Agencies to carefully consider all potential unintended consequences that could negatively impact the competitive position of CMBS lenders when issuing the Final Rule.

⁴ 78 Fed. Reg. at 57934.

⁵ If a bank issuer/sponsor uses its own regulatory capital returns as the basis for pricing the EHRI, it is likely that the institution would start with a minimum return requirement of 12.5 percent (the simple average of tier 1 common capital ratios reported by the six largest US banks at the corporate level in 2012). This equates to a minimum hurdle of approximately 37.5 basis points. The issuer would need to receive an additional margin on top of this corporate-wide return measure, especially given the nature of the credit and liquidity risks inherent in the EHRI. If assuming a 13-15 percent return is required of the EHRI, then the marginal cost to the borrower of risk retention is estimated to be approximately 40 - 50 basis points.

SUMMARY OF SIGNATORIES ISSUES AND RECOMMENDATIONS

Despite the Agencies' attempts to provide a viable solution for the CMBS marketplace in this Re-proposal, there are certain features that, if implemented as proposed, would cause material, and possibly disastrous unintended consequences. Again, the Signatories believe that they have offered, in their individual comment letters, a range of constructive solutions that fit within the Agencies key risk retention objectives - promoting sound underwriting and fair dealing. The below include some of the most contentious aspects of the Re-proposal for the CMBS marketplace:

- 1. Proposed Restriction on Cash Flows to Eligible Horizontal Risk Retention Interest** – We raise strong concerns about potential cash flow restrictions being placed on horizontal risk retention holders. The eligible horizontal risk retention interest (EHRI) recovery percentage, as proposed, would severely limit cash flow to horizontal risk retention holders due to restrictions linking CMBS payments to principal repayment, which for CMBS does not occur, for the most part, until near the expiration of the securitization. As proposed, the EHRI is unworkable in the context of the existing CMBS cash flow structure.
- 2. Horizontal Risk Retention Interests** – Although we commend the Agencies for allowing horizontal risk retention to be shared by two investors, we are concerned that this can only be held on a *pari passu* basis. We recommend that the Agencies also allow the horizontal risk retention to be split into senior and subordinate positions, in addition to the *pari passu* arrangement. Given that the Re-proposal substantially increases the amount of risk retention that must be held for the horizontal risk retention position, due to the change from par value to fair value, we strongly recommend that this increased risk retention requirement should have the flexibility to accommodate existing market structures, which the senior and subordinate horizontal risk retention option would allow.
- 3. Qualified Commercial Real Estate (QCRE) Loans** – Although the Agencies relaxed certain loan characteristics that qualify a loan as a “low risk” loan and thus exempted from risk retention, only 2.5 percent to 8 percent, depending on certain variables, of current mortgages comprising conduit CMBS would qualify for zero risk retention. This narrow QCRE loan compliance rate bring into question if the Agencies have fairly and optimally calibrated the underwriting characteristics of QCRE loans. We would strongly urge the Agencies to reconsider the Re-proposal's underwriting metrics for CMBS in order not to exclude CMBS loans that were underwritten based upon customary and prudent market practices. Looking back, these loans have performed well even in stressed environments.

4. **Single Borrower, Single Credit CMBS (SBSC)** – SBSC experienced a cumulative loss rate of only 0.2 percent compared to 2.79 percent for conduit CMBS.⁶ Despite this remarkable performance, over the 2009 to August 2013 period, only a *de minimus* number of SBSC loans would have qualified for QCRE loan status. Given this disconnect between SBSC loan performance and QCRE eligibility, the Agencies should reconsider the QCRE eligibility requirements for SBSC. Moreover, these transactions are transparent, and investors are able to perform granular due diligence. SBSC clearly fits into the parameters of a “low risk” loan and thus should be exempted from risk retention.
5. **B-Piece Buyer Affiliations** – The Re-proposal prohibits a third-party purchaser of the EHRI from being affiliated with a lender that contributes more than 10 percent of the loans to that deal. There is no compelling support for precluding B-Piece Buyers from investing in a deal to which its affiliate has contributed more than 10 percent of the loans, especially given the fact that such investments are wholly aligned with the fundamental objectives underlying the risk retention regime.
6. **Five Percent Quorum for Replacing the Special Servicer** – The low 5 percent quorum requirement could result in bond holders that control only 2.51 percent of the CMBS outstanding principal balance could replace the special servicer. The Agencies should take into consideration existing market standards for establishing the quorum requirement.

The Signatories urge that the Agencies make every effort to understand the economic impact the Re-proposal could have on the overall economy by conducting a rigorous cost-benefit and economic impact study prior to implementation.

Finally, the Signatories request that the Agencies pay special attention to a process recommendation. Given the unique nature of the Risk Retention rule and the joint ownership by six agencies, it is necessary that the regulatory community articulate a reasonable process for seeking clarifications to and exemptions under the Re-proposal that are consistent for all of the Agencies.

⁶ Source: Trepp.

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The Signatories recognize that the Agencies will have a significant burden in weighing and measuring comments. As such, we are ready to make available further resources and data where necessary to assist the Agencies in assessing the viability and impact of the recommendations included herein. We believe that the Agencies should appropriately craft the Final Rule to ensure a properly functioning and reliable CMBS market.

Thank you for the opportunity to submit comments on this critically-important rulemaking.

Sincerely,

American Resort Development Association
Building Owners and Managers Association International
CCIM Institute
Commercial Real Estate Finance Council
Financial Services Roundtable
Institute of Real Estate Management
International Council of Shopping Centers
Mortgage Bankers Association
NAIOP, Commercial Real Estate Development Association
National Apartment Association
National Association of Real Estate Investment Trusts
National Association of Realtors
National Multi Housing Council
Securities Industry and Financial Markets Association
Society of Industrial and Office Realtors
The Real Estate Roundtable