REGULATORS' LATEST RISK-RETENTION PROPOSAL REMAINS FLAWED

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On October 30, 2013, NAR as well as a coalition of real estate industry groups sent a formal comment letters to banking regulators in response to their joint August 28, 2013, proposal to implement Dodd-Frank "risk retention" language requiring financial institutions that package loans to retain 5 percent of the credit risk on their balance sheets.

The August 28 proposal, like the original (2011) version it replaces, seeks to better align sponsor and investor interests by providing sponsors with an incentive to control the quality of securitized assets.

NAR, which expressed fundamental concerns to regulators and lawmakers about the 2011 version, noted some "constructive revisions" in the agencies' latest proposal, and expressed appreciation for regulators' efforts to ensure integrity and discipline within the commercial real estate lending market.

Among key changes in the new draft proposal affecting commercial securitization, regulators eliminated the controversial premium capture cash-reserve account (PCCRA) provision, which would have required the creation of new accounts to cover potential losses resulting from securitization. In its place, the agencies proposed that risk retention generally be based on fair value measurements, instead of the par value of securities. Although this would permit greater flexibility in how securitization sponsors meet the 5 percent risk-retention requirement — e.g., allowing any combination of "horizontal" or "vertical" retention — the proposed new use of fair value will necessitate additional investor capital, raising concern about the potential for higher borrowing costs.

However, NAR in its latest comment letter stated that it remains concerned about the serious and, presumably, unintended economic consequences that the re-proposed rules could have on a reliable new issuance market for commercial mortgage backed securities (CMBS) and overall commercial and multifamily real estate credit capacity. The CMBS market is an important element of the over $3 trillion commercial real estate debt market, currently comprising roughly 26 percent of the overall market.

Key areas of concern with the new risk-retention proposal include:

• Appropriate Alignment of Interests: Neither the originally proposed rules nor the re-proposed rules acknowledge or account for existing "incentive alignment mechanisms" and forms of risk retention, such as existing B-piece investor retention and a special servicing structure for CMBS which serve to appropriately align incentives and create "skin in the game."

• Potentially harmful impacts on the supply of credit and the overall U.S. economy.

• Single-Borrower/Single-Credit (SBSC) Transactions — which contain only one loan (or a handful of cross-collateralized loans that essentially function as one loan), are transparent and extremely credit-worthy — should be exempt from the new risk-retention requirements. On this point, NAR said it is "very concerned about the implications of applying a 'one-size-fits-all' rule to this asset class," noting a potential increase in borrower costs of 20-30 basis points, increased warehouse risk, reduced credit quality and a more illiquid market

"This potential increase in borrowing costs could have the unintended consequence of reducing the credit quality of the underlying loans – thereby undermining the overall goal of risk retention," NAR continued. "In addition to raising borrowing costs, the market would potentially become less liquid which could result in reduced credit capacity for the overall commercial real estate market."

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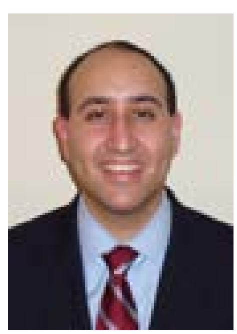

As NAR's Commercial Policy Representative, VIJAY YADLAPATI monitors and analyzes federal legislative and regulatory developments in order to shape the direction of today's policies. Additionally, Vijay lobbies the U.S. Congress and federal regulatory agencies to ensure that the interests of the commercial real estate industry are addressed.