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MORTGAGE BANKERS ASSOCIATION

Statement of
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On Behalf of the Mortgage Bankers Association

U.S. House of Representatives
House Committee on Oversight & Accountability
Subcommittee on Health Care & Financial Services

"Health of the Commercial Real Estate Markets and Removing Regulatory Hurdles to Ensure Continued Strength"

Tuesday, April 30, 2024
2:00 PM

Chairwoman McClain, Ranking Member Porter, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association[1] (MBA). My name is Jeff Weidell, and I am the Chief Executive Officer at Northmarq, a firm acting as a capital markets resource for commercial real estate investors that provides services involving top industry experts in debt, equity, investment sales, and loan servicing. I am also testifying in my capacity as the current chair of MBA's Commercial/Multifamily Board of Governors. Thank you for the opportunity to speak with you today.

In my written statement and through my remarks, I will provide an overview of the commercial/multifamily real estate sector, a "snapshot" of its current economic landscape, and details regarding immediate actions Congress and regulators can take – or avoid – to encourage sustainable development that ensures the continued strength of this vital portion of the American economy.

OVERVIEW OF THE COMMERCIAL REAL ESTATE (CRE) MARKET

The commercial real estate (CRE) market is big and diverse – with a range of different property types, geographic markets and submarkets, borrower and lender types, and loan and deal vintages. For example, the list of property types includes multifamily, office, retail, industrial, lodging, self-storage, and many others. These properties are located in real estate markets across the country – New York, Los Angeles, Miami, Atlanta, Pittsburgh, Des Moines, Detroit – and everywhere in between.

There are properties in downtown office corridors, entertainment districts, edge cities, retail strips, suburban neighborhoods, and exurban markets. They are owned by cross-border investors, sophisticated institutions and funds, public companies like REITs, private investors and individuals, and more. Meanwhile, the loans supporting these properties are either funded or subsidized by banks, life insurance companies, the housing Government Sponsored Enterprises or "GSEs" (Fannie Mae and Freddie Mac), the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA), the Commercial Mortgage-Backed Securities (CMBS) market, investor-driven lenders, and other capital sources.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 275,000 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 more than 2,000 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

This is all to say it is exceedingly difficult to paint the picture of commercial real estate with broad brushstrokes. CRE operates within three different market divisions – space, equity, and debt. Over the last two years, there have been significant changes in all three of these market niches.

In the space markets – the supply and demand for commercial real estate space – all eyes recently have been fixed on office properties and the impacts of hybrid work. Living in San Francisco, I can tell you I see the daily impacts of that shift – and would note the importance of the significant variety between and within office and other markets.

In the equity markets – which drive property values and sales activity – large amounts of capital have been raised to invest, but a lack of sales transactions has made pricing less transparent. Different price indices indicate commercial property prices could be down anywhere between 9 and 22 percent from their recent peaks. In general, existing owners are holding onto their properties unless something (e.g., loans that are maturing, property cash flows and major lease rolls, etc.) forces their hands.

In the debt markets, interest rates began to rise dramatically two years ago, which clearly changed the borrowing environment for a wide range of property owners and potential owners. Rate volatility has made pricing new deals challenging and many owners and lenders are holding on to their positions, hoping that falling rates will eventually bring some relief. Given where we had been, rates on 10-year Treasury notes “in the upper 4s” are a difficult pill for many property owners to swallow – given the significant resulting increases in debt payments.

The uncertainty across all these markets has led to a significant slowdown in CRE transaction activity. If a property owner does not need to act with regard to a sale or a refinancing, they generally have not. This has frozen the fluidity of the markets, with both sales transaction volume and mortgage borrowing down roughly 50 percent in 2023 from the previous year.

Focusing more specifically on the commercial mortgage market, it, too, is far from monolithic. MBA estimates there is $4.7 trillion of commercial mortgage debt outstanding, with about $2 trillion backed by apartment buildings, $740 billion by office, $415 billion each by retail and industrial, and then the remainder by a range of other property types.

Commercial banks hold the largest share (38 percent) at $1.8 trillion, but the bank total is split between apartments (roughly 34 percent of the bank total), office (19 percent), retail (9 percent), industrial (9 percent), and a range of other property types, including lodging, health care, self-storage, data centers, and more. The GSEs are the second largest holders of commercial mortgage debt at $1.0 trillion (21 percent of the total). Life insurance companies hold $733 billion (16 percent) and CMBS, Collateralized Loan Obligations (CLOs), and other Asset-Backed Securities (ABS) hold $593 billion (13 percent).

Succinctly summarized, the $4.7 trillion of commercial mortgage debt is highly diversified.

Delinquency rates on commercial mortgages have been rising, particularly for loans backed by office properties. Twenty percent ($929 billion) of the total commercial mortgage debt is set to mature in 2024. Multifamily makes up the largest piece of those maturities, at $257 billion, followed by office at $206 billion. Every property and every owner are in a uniquely different situation, driven by the particulars of their property, its market, the owner's particular financial situation, the timing of when the owner purchased the property, how much and when the owner borrowed, and more. That mix of variables will be critical to determining which properties and loans face challenges – and which do not.

Between 2014 – a full 10 years ago now – and mid-2022, CRE property values grew by 90 percent, and multifamily values grew by 144 percent. Simply put, if an owner has been holding their property over time, they have likely built a fair amount of equity.

The real challenge – and opportunity – is that the markets have reset from where they were just a few years ago – in terms of interest rates, property values, and, in some instances, the fundamental operations of the properties themselves. Owners, potential owners, developers, lenders, and other market participants are all working through the process of transitioning the CRE market to that new reality.

THE U.S. ECONOMY

The U.S. economy ended 2023 on a strong note and has remained more resilient than many had anticipated.

The gross domestic product (GDP) grew at a seasonally adjusted annual rate of 3.4 percent in the fourth quarter of 2023, down from 4.9 percent in Q3 but otherwise the strongest showing since the end of 2021. Consumer expenditures remained robust, with spending on goods growing at a real rate of 3.0 percent per year and spending on services growing by 3.4 percent. The preliminary GDP numbers for Q1 of 2024 showed continued economic growth, but at a pace roughly half that of the previous quarter.

The job market has been equally steady, adding a seasonally adjusted average of 212,000 jobs per month during Q4 of 2023 and 256,000 in January, 270,000 in February, and 303,000 in March. The unemployment rate was 3.8 percent in March.

The still-tight labor market has helped elevate hourly earnings to be 4.1 percent higher than they were a year ago. Headline inflation was 3.5 percent in March (down from its June 2022 peak of 9.1 percent) – meaning that earnings growth is once again outpacing the rise in prices.

The Federal Reserve continues to signal patience and a focus on incoming data, balancing inflation, labor market strength and the Fed Funds Rate, which has been held steady since last summer. Ten-year Treasury yields have spent most of this year above 4 percent, while the Secured Overnight Financing Rate (SOFR) has hovered above 5 percent.

PROPERTY FUNDAMENTALS

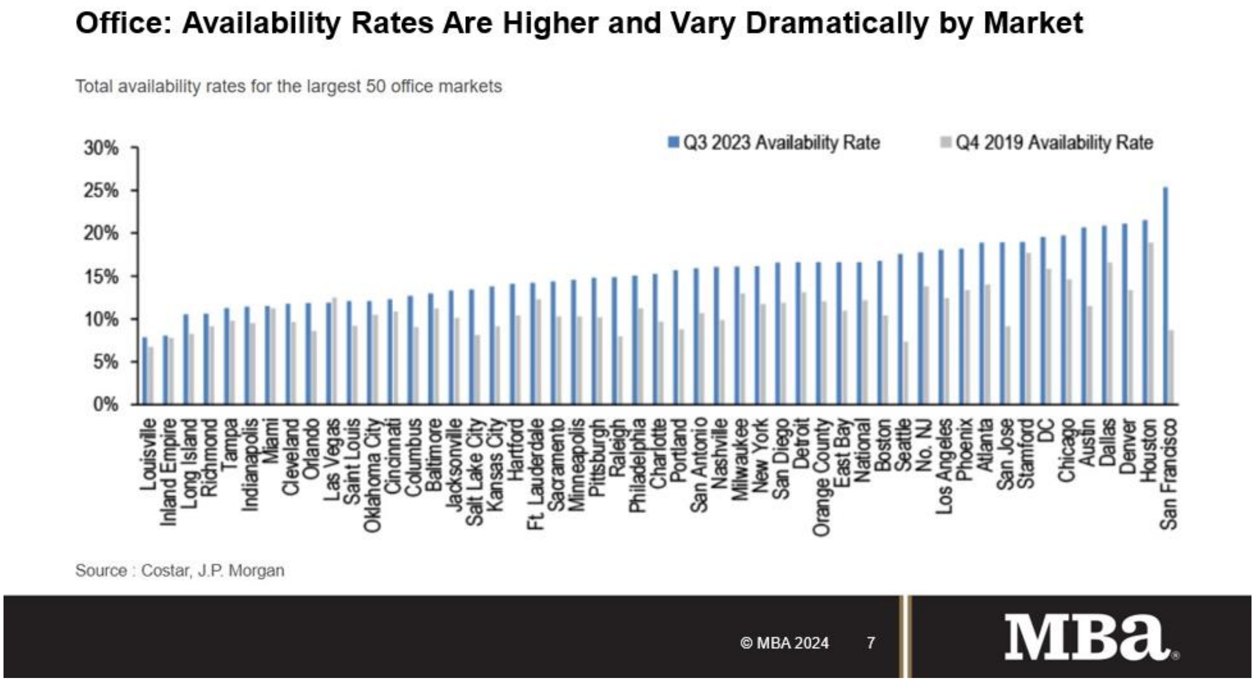
Commercial property markets are dynamic, with different property types moving in different directions, and significant variation by property type and subtype, market and submarket, quality, vintage, and more.

Office

In September 2022, MBA wrote a white paper looking into **office demand in a post-pandemic world**. The paper began by stating: *"Work-from-home has brought an existential question to the office market. Two-and-a-half-years into the pandemic, with office properties currently at 40 percent of their pre-pandemic occupancy, what's ahead for the sector?"*

Now, another year and a half later, that question remains largely unanswered, although we are starting to see some trends. Offices have seen an uptick in usage, with significant variation between markets and submarkets. Location and property quality definitely matter. In a recent note, J.P. Morgan noted, *"Focusing on the NYC office market and using a sample of Single Asset Single Borrower (SASB) office properties, we estimate that workers are returning to the office at a rate of 78% of their 2019 levels and workers are commuting to the office more during the middle of the week. Additionally, people who work in the Times Square neighborhood are returning to work at a higher rate relative to those who work in other NYC neighborhoods."*

We are starting to delineate the "survivors" more clearly – buildings that are attracting new leases and owners that are investing in the tax and insurance (and other) elements of keeping a building going. Those buildings will attract capital, and with it, new tenants. As other buildings and owners struggle, the universe of available office space will decline, bringing greater balance.



Retail

As MBA has noted previously, there are certain similarities between where the office market is today and where retail was a number of years ago. Questions about the future of malls and a general “over-retailing” of the United States cast a prior pall over investing and lending on retail properties. But consistent economic growth and the strength of the consumer have turned that narrative around. Retail is now among the more favored property types.

For example, JLL’s Q4 Retail Outlook noted*, “Retail net absorption surged 37.2% quarter-over-quarter to 17.6 million square feet – boosted by a significant jump in mall net absorption. Conversely, deliveries decreased 5.1% from the previous quarter. With little new construction and rising absorption, vacancy fell 20 basis points to 4.0% - the lowest on record since 2007.”*

Retail: Some Retail Sub-types Have Become "Comeback Kid"
Q4 2023 Conditions

Fundamentals	General retail	Malls	Power centers	Neighborhood and community	Strip centers	Total retail
Inventory	6,518,096,334	910,793,607	800,443,522	2,982,178,354	708,149,932	12,023,969,921
Vacancy	2.5%	8.5%	4.2%	5.8%	4.6%	4.0%
Net absorption	8,226,156	3,485,846	691,839	3,886,983	996,586	17,602,540
Net deliveries	7,812,073	(435,982)	217,200	783,262	503,648	9,210,327
Under construction	38,702,112	2,569,312	1,755,004	7,717,110	3,361,289	55,501,808
Market rent	$23.82	$33.35	$26.38	$23.81	$22.68	$24.69

Source: JLL

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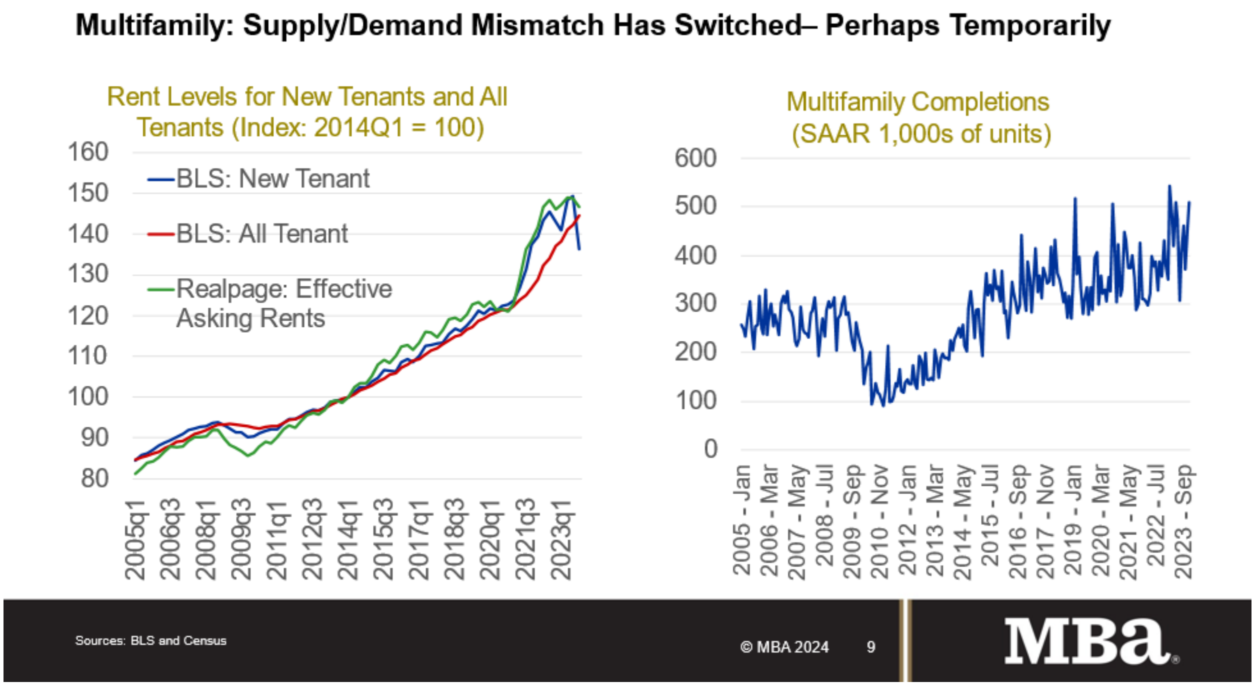
Apartment/Multifamily

After a number of years of demand significantly outstripping the supply of apartments, developers ramped up building activity and the reverse is now true. An annualized pace of more than 500,000 multifamily units were delivered in December 2023 and January 2024, compared to just more than 350,000 delivered in 2022. And there remain nearly 1 million more units currently under construction.

That new supply has brought the multifamily rental vacancy rate from 6.5 percent at the end of 2022 to 7.7 percent (as of the end of 2023). Following the dictates of basic economic theory, the rent pressure observed when demand exceeded supply has softened. A new series from the Bureau of Labor Statistics that tracks the rents paid by newly signed tenants showed those asking rents in Q4 2023 declined 4 percent from a year earlier. Because rents of in-place tenants were still catching up to the previous increases, Q4 rents for all tenants increased 5.3 percent from a year earlier.

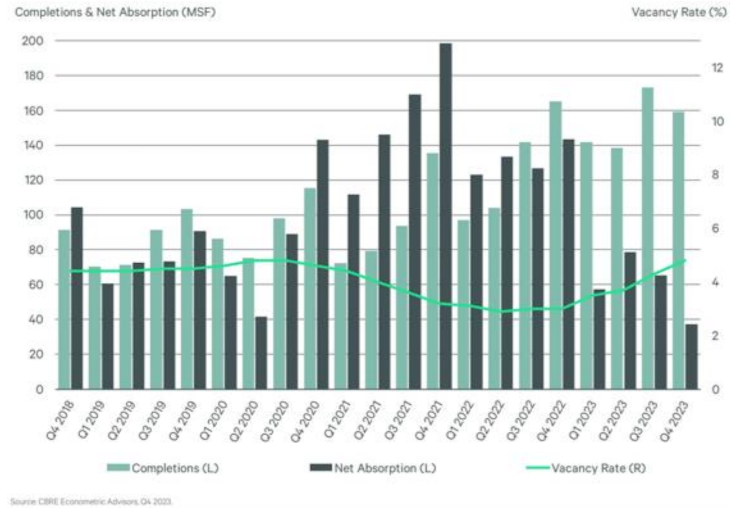


The moderation in rent growth will bring relief to many tenants and potential challenges to some owners whose expenses outpace income growth. It is also unlikely to significantly aid the many renter households whose incomes are below what it costs to build and maintain housing and who depend on some form of subsidy to make up the gap.

Industrial

Industrial market dynamics are – in broad terms – similar to those in multifamily. The onset of the pandemic led to a surge in demand that easily exceeded existing supply – driving vacancies lower and rents higher. Strong new development followed, bringing with it higher vacancy rates and more stability to rents. That, in turn, has slowed the development pipeline. For example, on their Q4 earnings call, Prologis noted, *"In closing, we know that the market is not yet out of the woods with regards to incoming supply, but the combination of a stronger backdrop, continued low level of starts, and a calmer capital markets environment has us optimistic that 2024 will be another great year."*

Industrial: Supply/Demand Mismatch Has Switched But Rent Rolls Generally Still Favorable



Source: CBRE

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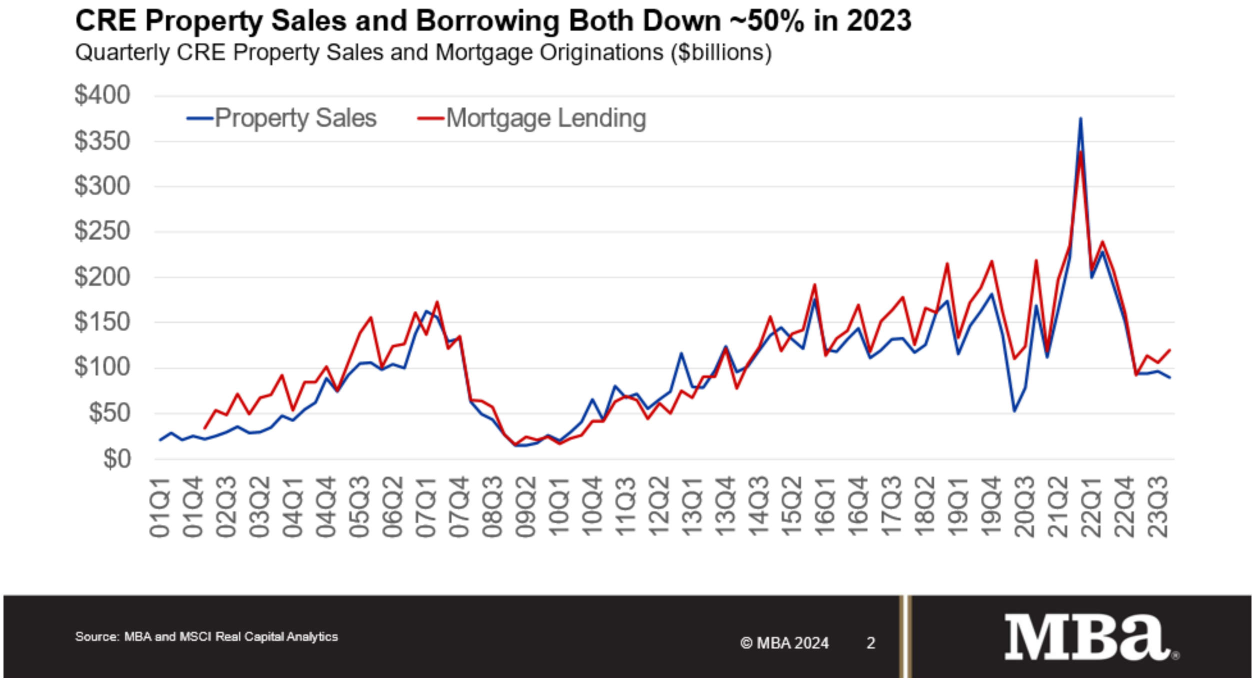
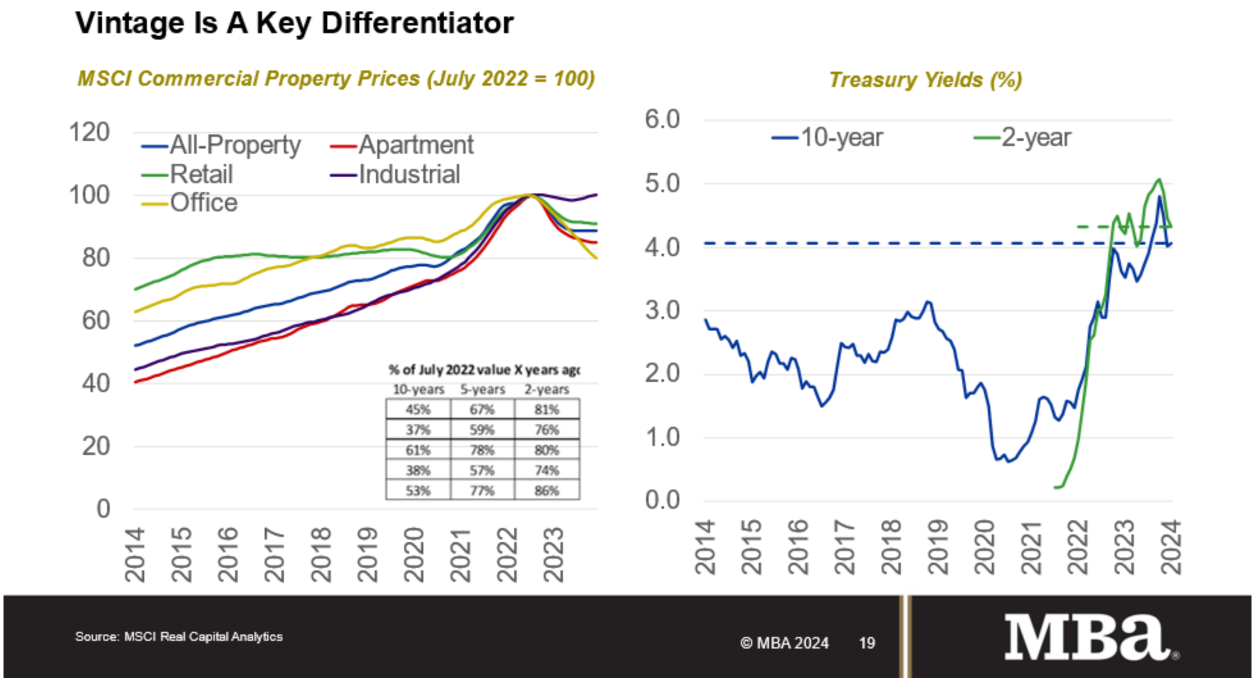
PROPERTY SALES

Sales of commercial real estate properties remained subdued during Q4 2023, capping a year of subpar activity. Sales activity in Q4 was 38 percent lower than a year earlier and down 51 percent for the year. The slower decline in Q4 is less a sign of market improvement and more the mathematical result of the fact that Q4 2022 had already seen a significant slide from previous quarters.



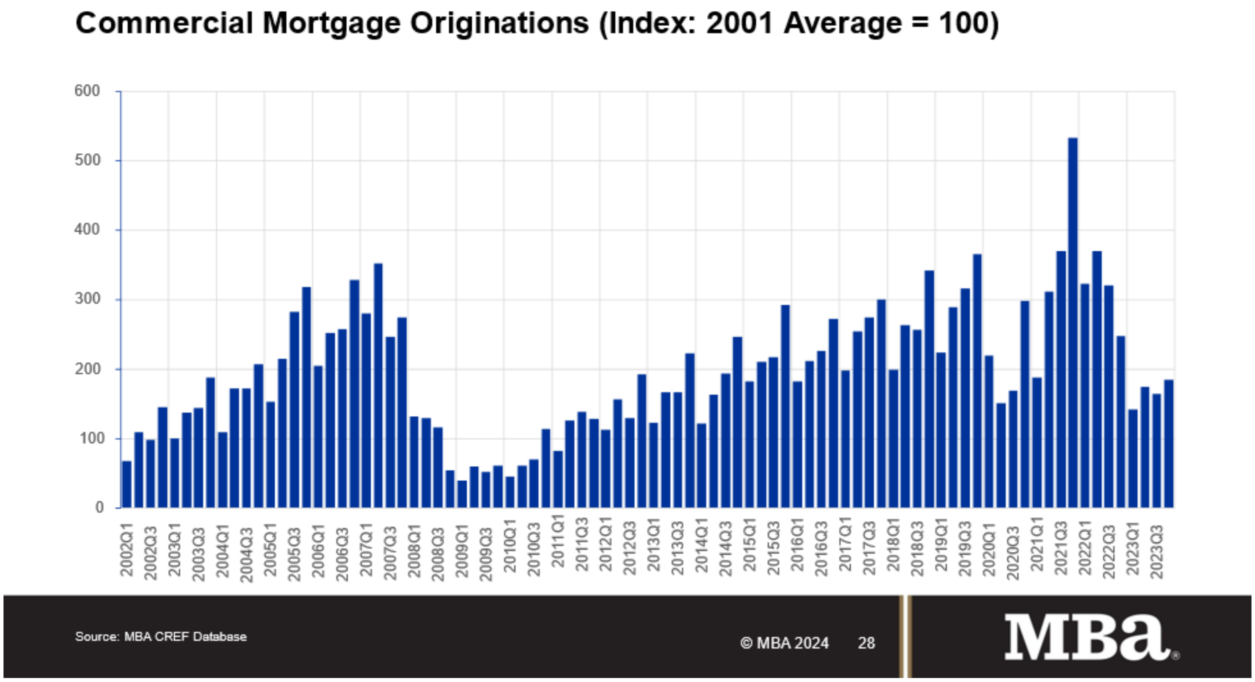
Counter to what one might conclude from the headlines, the drop-off in sales was not all about office properties. While sales of office properties slid 56 percent from 2022 to 2023, sales of retail properties fell 38 percent, industrial fell 44 percent, hotel fell 47 percent, and apartments fell 61 percent.

The lack of sales transactions continues to leave a “blind spot” on property valuations, with different price indexes showing different results. A CRE price index used by the Federal Reserve reported a 6 percent value decline during Q4 2023, bringing values 9 percent lower than their recent peak. Green Street also reported a 6 percent Q4 decline, but with values now 22 percent lower than peak. MSCI’s Real Capital Analytics Commercial Property Price Indexes (CPPI) reported property values were flat during Q4 2023 and down 11 percent from peak. Until sales activity picks up, it is likely the various price indexes will continue to have a “muddy” view into values.



MORTGAGE ORIGINATIONS

Borrowing and lending backed by commercial real estate remained subdued to close out 2023. The fourth quarter saw a small pick-up from the previous quarter, as is usually the case, but was still down about 25 percent from 2022's already suppressed fourth-quarter pace. For the year, mortgage originations were about 50 percent below 2022 levels, with every major property type and capital source experiencing a decline.



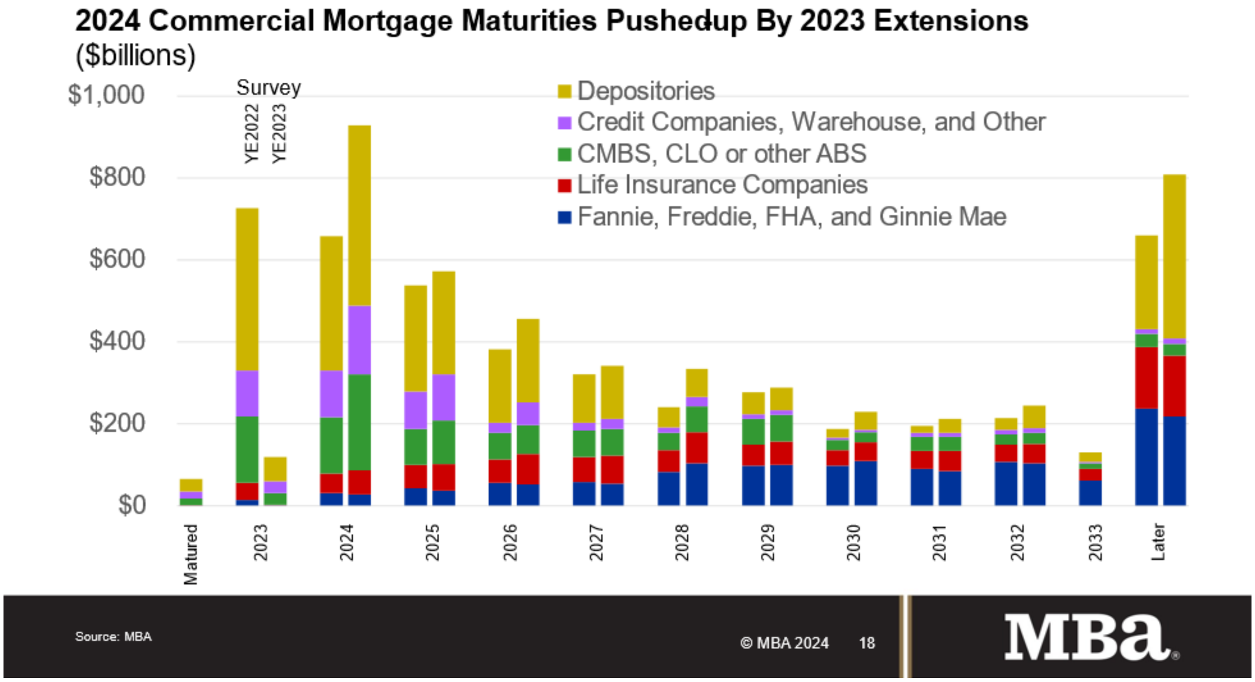
Commercial and multifamily mortgage loan originations were 25 percent lower in Q4 of 2023 compared to a year earlier and increased 13 percent from Q3 of 2023.

Decreases in originations for office, health care, multifamily, and industrial properties led to the overall drop in commercial lending volumes when compared to Q4 of 2022. There was a 68 percent year-over-year decrease in the dollar volume of loans for office properties, a 39 percent decrease for health care properties, a 27 percent decrease for multifamily properties, and a 7 percent decrease for industrial properties. Retail properties increased 50 percent, and hotel property loan originations increased 81 percent, respectively, compared to Q4 of 2022.

Among investor types, the dollar volume of loans originated for depositories decreased by 53 percent year-over-year. There was a 29 percent decrease for GSE loans, a 6 percent decrease in life insurance company loans, and a one percent decrease for investor-driven lender loans. And there was a 144 percent increase in the dollar volume of CMBS loans.

MORTGAGE MATURITIES

The lack of transactions and other activity last year, coupled with built-in extension options and lender and servicer flexibility, has meant that many loans that were set to mature in 2023 have been extended or otherwise modified and will now mature in 2024, 2026, 2028 or in other coming years. These extensions and modifications have pushed the amount of CRE mortgages maturing this year from $659 billion to $929 billion.



The loan maturities vary significantly by investor and property type groups. Just $28 billion (3 percent) of the outstanding balance of multifamily and health care mortgages held or guaranteed by Fannie Mae, Freddie Mac, FHA, and Ginnie Mae will mature in 2024. Life insurance companies will see $59 billion (8 percent) of their outstanding mortgage balances mature in 2024. By contrast, $441 billion (25 percent) of the outstanding balance of mortgages held by depositories, $234 billion (31 percent) in CMBS, CLOs, or other ABS and $168 billion (36 percent) of the mortgages held by credit companies, in warehouse, or by other lenders will mature in 2024.

By property type, 12 percent of mortgages backed by multifamily properties will mature in 2024, as will 17 percent of those backed by retail and 18 percent for healthcare properties. Among loans backed by office properties, 25 percent will come due in 2024, as will 27 percent of industrial loans and 38 percent of hotel/motel loans.

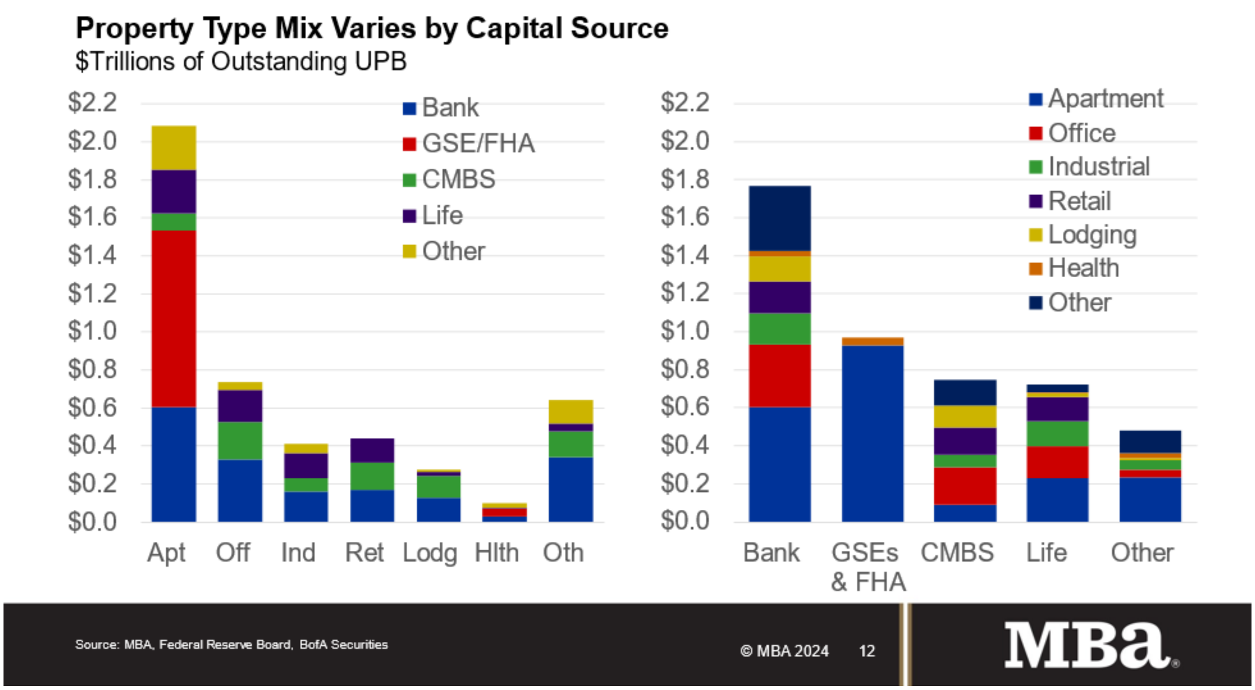
Commercial mortgages tend to be relatively long-lived, spreading maturities out over several years. Volatility and uncertainty around interest rates, a lack of clarity on property values, and questions about some property fundamentals have suppressed sales and financing transactions. This year’s maturities, coupled with greater clarity in those and other areas, should begin to break the logjam in the markets.

MORTGAGE DEBT OUTSTANDING

The amount of commercial mortgage debt outstanding grew in the final quarter of 2023 and for the year as a whole. However, the increase was among the slowest paces since the mid-2010s.

Total mortgage debt outstanding rose by 0.9 percent ($41.8 billion) to $4.69 trillion in Q4 of 2023. Multifamily mortgage debt grew by $25.0 billion (1.2 percent) to $2.09 trillion during Q4.

Commercial banks continue to hold the largest share (38 percent) of commercial mortgages at $1.8 trillion. GSE portfolios are the second largest holders of commercial/multifamily mortgages, at $1.0 trillion (21 percent of the total). Life insurance companies hold $733 billion (16 percent), and CMBS, CLO, and other ABS issues hold $593 billion (13 percent).



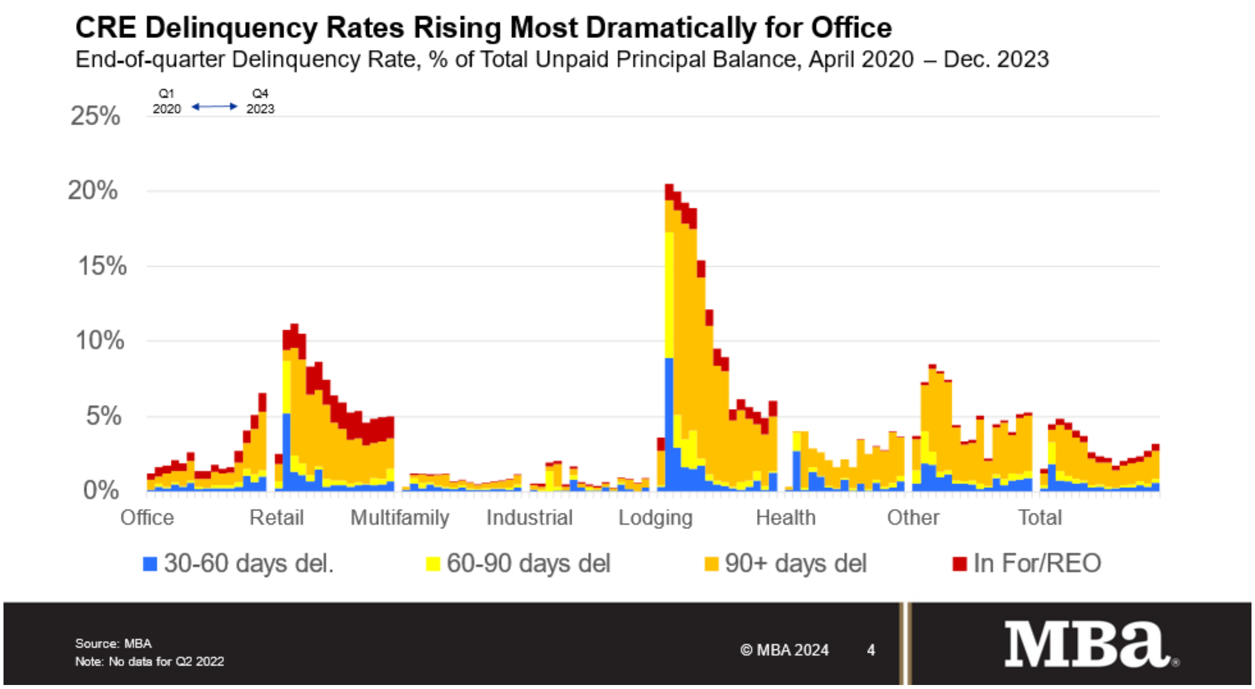
Looking solely at multifamily mortgages, GSE portfolios hold the largest share of total debt outstanding at $1.0 trillion (48 percent of the total), followed by commercial banks with $612 billion (29 percent), life insurance companies with $235 billion (11 percent), state and local governments with $116 billion (6 percent), and CMBS, CLO and other ABS issues with $67 billion (3 percent).

Every major capital source increased its mortgage holdings during the year. Mortgage originations were down by roughly 50 percent in 2023 compared to 2022, but that meant that few loans were paying off, helping maintain portfolio sizes even in the face of lower inflows.

LOAN PERFORMANCE

While overall delinquencies remained flat, the delinquency rate for loans backed by office properties rose again during the first three months of this year. Loans across property types are adjusting to higher interest rates and uncertainty about property values, but the continued fog around the impact of hybrid work adds another challenge for office properties and their loans.

As noted previously, the commercial real estate market is large and diverse, with a wide mix of property types, geographic markets and submarkets, property and loan sizes, owners, lenders, vintages, and other characteristics. With 20 percent of the $4.7 trillion of outstanding commercial mortgage debt maturing this year, each of those factors will play a part in determining which loans may face challenges and which may not.



The balance of commercial mortgages that are not current was unchanged in the First Quarter 2024 (compared to Q4 2023).

- 96.8% of outstanding loan balances were current or less than 30 days late at the end of the quarter, unchanged from the previous quarter.
    - 2.5% were 90+ days delinquent or in foreclosure/“real estate owned” (REO), up from 2.3% the previous quarter.
    - 0.3% were 60-90 days delinquent, unchanged from the previous quarter.
    - 0.4% were 30-60 days delinquent, down from 0.6%.

- Loans backed by office properties drove the increase.
    - 6.8% of the balance of office property loans were 30 days or more days delinquent, up from 6.5% at the end of last quarter.
    - 6.3% of the balance of lodging loans were delinquent, up from 6.1%.
    - 4.7% of retail balances were delinquent, down from 5.0% the previous quarter.
    - 1.2% of multifamily balances were delinquent, unchanged from the previous quarter.
    - 1.2% of the balance of industrial property loans were delinquent, up from 0.9%.

Every major capital source has seen an increase over the last six months, as higher interest rates, uncertainty about property values, and challenges in some property fundamentals work their way through the markets.

Based on the unpaid principal balance (UPB) of loans, delinquency rates for each group at the end of the fourth quarter of 2023 were as follows:

- Banks and thrifts (90 or more days delinquent or in non-accrual): 0.94 percent, an increase of 0.09 percentage points from the third quarter of 2023;
- Life company portfolios (60 or more days delinquent): 0.36 percent, an increase of 0.04 percentage points from the third quarter of 2023;
- Fannie Mae (60 or more days delinquent): 0.46 percent, a decrease of 0.08 percentage points from the third quarter of 2023;
- Freddie Mac (60 or more days delinquent): 0.28 percent, an increase of 0.04 percentage points from the third quarter of 2023; and
- CMBS (30 or more days delinquent or in foreclosure/REO: 4.30 percent, an increase of 0.04 percentage points from the third quarter of 2023.

Long-term interest rates have come down from their highs of last year, which should provide some relief to some loans, but many properties and loans still face higher rates, uncertainty about property values and – for some properties – changes in fundamentals. Each loan and property faces a different set of circumstances, which will come into play as the market works through loans that mature this year.

REGULATORY IMPEDIMENTS

Basel III End Game

The Basel III End Game proposal (Basel NPR) poses unwarranted risks - to the housing and real estate markets specifically - and contradicts many of the Biden administration's policy goals, including increasing affordable housing (both ownership and rental), fostering bank competition over consolidation, and the closing of significant racial homeownership and wealth gaps.

The proposed changes effectively increase capital requirements at larger banks by an estimated 15 to 20 percent – large enough to impact credit availability economy-wide, as well as which lines of business banks choose to support – with potential implications for the entire mortgage market, including commercial and multifamily lending.

For commercial real estate specifically, the Basel NPR contains several concerning provisions that could negatively impact the availability of commercial credit. For example, the NPR includes an expanded definition of "defaulted real estate exposure" for commercial loans. This expanded definition is broader than the current capital rule and requires banks to evaluate certain loan assets at the borrower level rather than the asset/exposure level. This will result in current loans requiring an elevated risk weight (and increased capital required) if the borrower has any other loan with any other creditor in default. This expanded definition is problematic, undoable, and would place significant cost and operational burdens on banks, as:

- Banks do not have a system or framework in place to track in real-time all debt obligations of their borrowers and any parent companies/owners of the borrower.

- Creditors do not notify other creditors of a default or cure event, nor is there a uniform national data repository for real estate loan status, including defaults and cures.

Also, most commercial real estate loans are made on a non-recourse basis (secured only by the property) to a bankruptcy-remote special purpose entity with no other real estate obligations. In these cases, evaluating default at the exposure level and the obligor level is the same. The default status of mortgages made to and backed by single-purpose, bankruptcy-remote entities that own income-producing properties should be entirely dependent on the status of that particular loan.

Furthermore, the Basel NPR could raise capital charges on undrawn warehouse lines of credit, thereby decreasing financing opportunities available to commercial real estate lenders and borrowers – and making securitization executions more expensive.

The Basel NPR also lacks the robust economic impact analysis that usually accompanies such a significant change in bank capital standards – a scant 15 pages of impact assessment out of nearly 1,100 total pages for the rule. Any major change in public policy warrants a reasonable consideration of its effects and impacts – especially when the policy change directly impacts everything from the cost of funds for our largest financial institutions to the costs of multifamily housing.

Given the broad bipartisan criticism of the Basel NPR to date, Congress should continue to push for reconsideration of the proposal until a broader consensus can be reached. More specifically, Congress should ask the engaged banking agencies – the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) – to strongly consider the recommendations in the MBA comment letter and conduct a more rigorous and thoughtful impact analysis prior to the finalization of any new capital framework.

Our recommendations provide targeted fixes to the proposed capital rule – and address long-standing problems with the current rules – that will strengthen the stability of our commercial lending and housing finance system by incentivizing large banks to increase their direct and indirect role in the market.

Rent Control

Early last year, the Biden administration announced actions to "enhance tenant protections and further principles of fair housing." The announcement included new actions by several federal agencies and a set of principles called the *"Blueprint for a Renters Bill of Rights."* Included in the set of federal agency actions was an examination by the Federal Housing Finance Agency (FHFA) of "proposed actions promoting renter protections and limits on egregious rent increases." In January this year, FHFA released a summary of responses received to its May 2023 Request for Input (RFI) on resident-centered practices at multifamily properties backed by Fannie Mae and Freddie Mac.

The U.S. continues to suffer from a significant shortage of affordable housing. Enacting new or expanded obligations, like rent control, would disincentivize participation in the GSEs' multifamily programs. The focus of federal housing policy must be on increasing that supply rather than creating potentially duplicative and onerous federal regulations that interfere with state and local laws meant to govern the housing provider and resident relationship.

For decades, the adoption of rent control policies by states and localities has been shown to decrease affordable housing supply and disproportionately benefit higher-income households. An example of rent control significantly reducing housing supply was recently seen in St. Paul, Minnesota. In November 2021, voters in St. Paul passed a rent control measure capping annual rent increases at 3%. As a result, according to HUD data, residential building permits decreased by approximately 50% from 2021 to 2022, the year following the passing of the rent control measure.[2] Alternatively, during that same period from 2021 to 2022, Minneapolis saw an increase in residential building permits by approximately 15%[3]. Even with major enhancements/amendments to the program, St. Paul is still hampered by a severe lack of supply of affordable rental housing.

The administration should refine and prioritize its *Housing Supply Act Plan*, avoiding the application of rent control principles – under the guise of tenant protections – to the Fannie/Freddie or FHA multifamily financing programs.

[2] See 2021 vs 2022 for St. Paul, Ramsey County, MN at: [SOCDS Building Permits Database (huduser.gov)]
[3] See id for Minneapolis, Hennepin County, MN.

Home Mortgage Disclosure Act (HMDA)

HMDA requires mortgage lenders to collect and report information on specific data points pertaining to their lending practices. The *Dodd-Frank Act of 2010* (DFA) transferred HMDA enforcement to the Consumer Financial Protection Bureau (CFPB) and authorized the CFPB to require the collection of additional mortgage lending information. CFPB finalized the new rules amending HMDA regulations (Regulation C) on October 15, 2015, with most new Dodd-Frank HMDA provisions taking effect on January 1, 2018.

MBA believes the CFPB should further amend HMDA regulations to fully exempt business-to-business loans secured by multifamily property from HMDA reporting. Such multifamily loans do not involve consumers, so these transactions should fall outside of the CFPB's statutory consumer-focused mission and objectives. Moreover, applying HMDA reporting requirements designed with single-family lending in mind to multifamily lending is unduly burdensome. Many multifamily lenders have a low volume of loans (but still meet the reporting thresholds) and do not have the economies of scale to bear the burden of developing, implementing, and maintaining the systems and processes necessary to support HMDA reporting. This is particularly the case for multifamily lenders, who generally do not have access to the full range of third-party service provider options for HMDA reporting and for which the HMDA reporting process requires a substantial amount of manual processing.

Section 1071 Small Business Reporting

On March 30, 2023, the CFPB released its small business loan reporting final rule that implements Section 1071 of the DFA. While enforcement of the final rule is suspended until the Supreme Court makes its final decision regarding the constitutionality of the funding of the CFPB, if implementation moves forward, the rule's requirements will place a significant burden on commercial lenders. Under the final rule, lenders who originate at least 100 small business loans in each of the preceding two calendar years are required to report certain demographic information. A small business has gross revenue of $5 million or less in its most recent fiscal year.

MBA urged the CFPB to include an overall exemption for loans to finance income-producing investment properties in the final rule, but the CFPB failed to do so. It is well recognized that investment property lending is a category of lending distinct from small business lending. For example, the federal prudential regulatory agencies provide separate supervisory guidance for small business lending and investment property lending, and Small Business Administration (SBA) regulations exclude real estate firms that hold real property for investment purposes from eligibility for SBA small business loan programs. As a result, investment property lending should not be considered small business lending within the scope of Section 1071, even where an investor may be "small".

POTENTIAL POSITIVE STEPS

HUD

Simply stated, HUD is quickly becoming the most expensive and inefficient place to originate an apartment loan, has outdated program requirements, employs the use of unnecessary and exorbitant fees – and, as a result, lender participation in its multifamily program volume is historically low.

HUD multifamily volume is down significantly over recent years in all aspects of the Multifamily Accelerated Processing (MAP) program. Volume decreased 58% from FY 2022 to FY 2023 and, based on annualized Q1 FY 2024 data, volume is on pace to be down another 42% from FY 2023 to FY 2024. That would be a 75% decrease from FY 2022 to FY 2024.

The federal government has an opportunity to spur the production of rental housing through the HUD MAP program, but improvements are greatly needed. Specifically, HUD should reduce the multifamily mortgage insurance premium (which is priced too high for the minimal amount of risk the government takes on with the HUD multifamily program), reduce application and other closing fees, and reconsider and ease program requirements that raise the cost of building rental housing.

<u>Reduce Multifamily Mortgage Insurance Premium</u>

The administration has broadly focused on the use of hidden fees, including the potential elimination of unnecessary fees for consumers. It is ironic, therefore, that HUD itself has placed burdens on renters today by imposing hidden, duplicative, and unnecessarily high fees on developers and providers of housing. These costs result in fewer units being developed and higher rents for tenants.

The mortgage insurance premium (MIP) charged to FHA borrowers is designed to protect taxpayers and is meant to reflect the risk to the FHA General Insurance and Special Risk Insurance (GI-SRI) Fund. However, during the last 12 years, HUD has insured more than $170 billion of multifamily loans, collecting premiums of $3 billion from FHA multifamily borrowers, and yet has incurred a loss of just $27 million (from only 7 properties) on multifamily loans. Clearly, the premium rate far outweighs the risk to the taxpayer. Recently, HUD was able to demonstrate the benefits they have seen from reducing the single-family MIP. The premium reduction helped more than 682,000 borrowers save an average of $876 annually, saving them nearly $600 million collectively in just the last year. Reducing the multifamily premium would result in similar benefits for renters and for housing production.

<u>Reduce Application and Other Closing Fees</u>

HUD's application fee adds additional cost to the already high price of FHA financing. Per the MAP Guide, HUD's non-refundable application fee for a multifamily FHA loan is $3 per $1,000 of the requested mortgage amount. This fee is unnecessarily high and adds to the increasing difficulty of developing FHA-insured properties, especially during these challenging times of inflation and elevated costs.

HUD loans also come with a significant list of fees both at closing and through the servicing of a property. These fees are both costly and duplicative. For example, Mortgagee Letter 2013-13, "Lender Delegation of Non-Critical Repair Administration," clarifies that for projects when the HUD lender is delegated responsibility for non-critical repairs, the inspection fee "… will be waived if the total cost of repairs is less than $100,000. Otherwise, the inspection fee paid to HUD may not be waived." The Mortgagee Letter further states that the servicing lender must engage a third-party inspector. Therefore, the borrower ends up paying an inspection fee for both the third-party inspector who does the work, and HUD, who does not do the inspection. These fees are not nominal, and often are more than $10,000. This policy is particularly perplexing as HUD requires payment of a fee with no benefit or service provided.

The number of third-party reports required by HUD also goes far beyond what is required from any other type of loan. These studies are very costly and time-intensive and often delay construction for properties. Some examples of these reports include noise surveys, nesting bird surveys, vibration studies, a fall study if properties are located proximate to certain free-standing structures such as a water tower, cell tower, high voltage utility pole, a seismic engineering report, a pipeline risk analysis, and more. Developers also are often required to provide "will-serve" letters from schools, hospitals, and police and fire stations -- which duplicates what is provided for or required in the zoning and permitting process.

<u>Reconsider Program Requirements that Raise the Cost of Building Rental Housing</u>

Lenders are very concerned about the new regulations creating new floodplain and energy efficiency standards that will make FHA financing nearly impossible. These new rules rely on government-provided Climate-Informed Science Approach (CISA) Maps, which have yet to be created for most of the country. The new floodplain standard requires significant changes to site development including a large amount of fill and increased elevations. Soil import from certified fill sites may require additional transport costs if distances for such are farther from the site. Earthwork and compacting costs of the additional fill may increase project costs above an affordable level for the development. Based on our members' conversations with builders, the additional costs of construction are estimated to be between $10-15k per unit. The rule will also likely hinder rehabilitation efforts for existing structures due to triggering elevation requirements, which would be cost-prohibitive.

HUD last week also published new energy efficiency standards, which require all FHA-insured properties to use the 2021 International Energy Construction Code (IECC) building standard. HUD's notice of preliminary determination in the *Federal Register* was based largely on a report prepared for the U.S. Department of Energy. The report is widely flawed. For example, the report determined that the simple payback period for the construction costs of the 2021 IECC over the 2018 IECC averaged over 10 years nationwide, but their analysis of cost-effectiveness is based on a 30-year period. This ignores important investment and construction cost considerations by developers of rental apartments. Apartment investors work with much shorter investment timeframes of 5-10 years.

Today, most states use energy codes that are effectively the 2009 IECC standard. The giant leap in building standards up to the 2021 standard will significantly increase construction costs and will simply price developers out of building their projects, further exacerbating the shortage of multifamily housing development. Furthermore, since only 18 states currently use the 2021 building code, those states will not be prepared to enforce the new building code, adding delays and costs in finding authorized building inspectors. FHA properties will face far higher costs than any other properties due to this requirement, which will significantly impact the supply of new affordable rental housing.

Property Insurance

Property insurance has become an acute issue in the commercial real estate market. Many insurers and re-insurers have withdrawn from states (e.g., California, Florida, Texas, and Louisiana) amid greater severity of wildfire and natural catastrophes that have led to widespread property losses. MBA's commercial member lenders have reported the need to either "force-place" insurance or reduce lending due to the cost and availability of property insurance.

Property premiums in the U.S. continue to increase and are driven by continued losses, rising costs in reinsurance, and limited new capacity from insurers. However, even with higher premiums, insurance (and re-insurance) companies still face significant financial losses and thus have withdrawn many of their offerings in high-risk areas.

To promote market stability and insurer solvency, MBA urges the Congress – on an individual and collective basis – to work with insurance commissioners in their individual states, the Treasury Department, HUD, FHFA, the White House, congressional committee leaders, and other key stakeholders to address the availability and affordability of property insurance.

ACTIONS CONGRESS SHOULD TAKE

Congress could be instrumental in addressing the shortage of affordable and market-rate multifamily housing in the U.S. For example, there are several bipartisan, bicameral tax proposals – as well as bills that provide programmatic incentives for state/local governments – that can help support an increase in affordable housing supply, benefiting low- and middle-income renters and buyers and enhancing existing affordable housing programs and initiatives.

Affordable/Multifamily Housing

Legislation that would tackle the shortage of affordable rental units and address inflation impacts includes:

- The *Tax Relief for American Families and Workers Act of 2024* (H.R. 7024) – The Senate should swiftly consider this bill that the full House overwhelmingly approved by a bipartisan vote of 357 to 70 in late January. The package includes important Low-Income Housing Tax Credit (LIHTC) program enhancements that would help produce an estimated 200,000 additional rental units nationwide by: (1) restoring a LIHTC ceiling increase from 9 percent to 12.5 percent for calendar years 2023 through 2025, thereby allowing states to allocate more credits for affordable housing projects; and, (2) temporarily lowering the Private Activity Bond (PAB) threshold test from 50 percent to 30 percent for 4 Percent LIHTC property projects with an issue date before 2026.

- *Affordable Housing Credit Improvement Act* (AHCIA) – H.R. 3238, sponsored by Reps. Darrin LaHood (R-IL) and Susan DelBene (D-WA) in the House, and S. 1557, sponsored by Senators Maria Cantwell (D-WA) and Todd Young (R-IN) in the Senate, would expand and strengthen the LIHTC by increasing the per capita dollar amount of the credit and its minimum ceiling amount (extending the inflation adjustment for such amounts). The proposal would address the nationwide affordable housing shortage by supporting the construction of an estimated two million plus new affordable rental housing units over the next decade, ensuring the program better serves a variety of at-risk and underserved communities.

- *Build More Housing Near Transit Act* – S. 3216, sponsored by Senators Brian Schatz (D-HI) and Mike Braun (R-IN), and H.R. 6199, sponsored by Rep. Scott Peters (D-CA) and Cathy McMorris Rodgers (R-WA), would include incentives in targeted transportation grants designed to increase mobility options and access to affordable housing.

- *Housing Supply and Affordability Act* – S. 3684, sponsored by Senators Amy Klobuchar (D-MN) and Tim Kaine (D-VA), and H.R. 7132, sponsored by Reps. Brian Fitzpatrick (R-PA), Lisa Blunt-Rochester (D-DE), and Joyce Beatty (D-OH), would create a new Local Housing Policy Grant (LHPG) program administered by HUD, which would provide grants to states, localities, tribes, and regional municipal and county coalitions to support local efforts to expand housing supply.

FHA Statutory Loan Limits

MBA supports S.3682, sponsored by Senator Bob Menendez (D-NJ), a bill that would: (1) raise the statutory loan limits for FHA-insured multifamily projects, and (2) change the future annual inflationary adjustment from the Consumer Price Index (CPI) to the Price Deflator Index of Multifamily Residential Units Under Construction ("Price Deflator"). The Price Deflator index is released by the Census Bureau to accurately track inflation in residential construction.

- FHA's base statutory limits define the amount of multifamily mortgages HUD will insure. These mortgages are also capped by other factors such as debt service coverage and loan-to-value requirements.

- FHA Multifamily statutory base limits have not been adjusted since 2003.

- Changing the inflation-adjustment index for these loan limits from the CPI to the Price Deflator index (from 2003 to present), would mean that base limits for 2022 (and beyond) would be 26% higher than the current levels.

Office Conversions

MBA supports incentivizing adaptive reuse of underutilized commercial properties. Prior Senate legislation would have provided a 20 percent tax credit to convert qualified office buildings for other uses, including residential use. This Congress, Rep. Jimmy Gomez (D-CA) has introduced similar legislation, H.R. 419. MBA supports the Gomez bill, but would like to see it modified to: enable other types of commercial properties (e.g., shopping centers and hotels) to qualify for the tax incentive; ensure REITs could utilize the benefit; and, clarify that the credit does not reduce other tax benefits, including the LIHTC program.

Workforce Housing/Middle-Income Housing Tax Credit (MIHTC)

MBA supports the *Workforce Housing Tax Credit Act*, bipartisan legislation introduced by Sens. Ron Wyden (D-OR) and Dan Sullivan (R-AK) in the Senate (S. 3425), and Reps. Jimmy Panetta (D-CA) and Mike Carey (R-OH) in the House (H.R. 6686). This proposal would establish a new tax credit to produce affordable rental housing for households earning 100% or less of the area median income (AMI). The Workforce Housing Tax Credit Act, which is designed to supplement the highly successful LIHTC program, would address the housing shortage for individuals who comprise the very fabric of strong communities nationwide, including teachers, firefighters, nurses, and police officers whose wages are not keeping pace with costs.

YIMBY

MBA supports the *Yes In My Back Yard (YIMBY) Act*, bipartisan legislation sponsored by Sens. Todd Young (R-IN) and Brian Schatz (D-HI) in the Senate (S. 1688) and Reps. Derek Kilmer (D-WA) and Mike Flood (R-NE) in the House (H.R. 3507). The *YIMBY Act* would help eliminate discriminatory land use policies and remove barriers that depress the production of housing in the United States. By requiring Community Development Block Grant (CDBG) recipients to report periodically on the extent to which they are removing discriminatory land use policies, and promoting inclusive and affordable housing, the *YIMBY Act* will increase transparency and encourage more thoughtful and inclusive development practices.

Other Key CRE Tax Considerations

Regardless of the 2024 election cycle outcomes, Congress must prepare for the 2025 expiration of many key elements of Public Law 115-97, the *Tax Cuts and Jobs Act (TCJA).* MBA commends the preparations that have already begun – on both sides of the political aisle – to plan for that consequential debate.

In that vein, key provisions impacting the Section 199A small business "pass-through" deduction against Qualified Business Income (QBI), bonus depreciation (leasehold improvements/qualified improvement property), business interest deductibility (the Earnings Before Interest, Taxes, Depreciation, and Amortization or “EBITDA” definition), and Opportunity Zones are all set to expire (or have expired).

Other important provisions that could negatively impact CRE stakeholders, if either altered or considered as part of the 2025 debate to pay for other changes to the tax code, include: changes to the capital gains rate, the treatment of the Net Investment Income Tax (NIIT) as applied to certain forms of income, Section 1031 Like Kind Exchanges, carried interest, cost recovery (depreciation recapture), step-up in basis (taxing gains at death), certain partnership tax reforms, and/or the taxing of yet-unrealized gains.

Given the crucial role CRE plays in the sustained health of the American economy, MBA will continue to urge the Congress to carefully weigh the impact of any potential tax changes on the appetite for continued investment in commercial real estate. We look forward to serving as a resource to members of this subcommittee – and your colleagues in both the House and Senate – as that debate begins to intensify in the coming months.

CONCLUSION

Thank you again for this opportunity to represent the MBA – and the commercial real estate finance industry – and appear before you today to discuss CRE market dynamics.

Our association and its members look forward to collaborating with you and your offices to advance the recommendations – both legislative and regulatory – mentioned within my statement.

I look forward to answering any questions you may have.