April 30, 2024

The Honorable Lisa McClain
Subcommittee on Health Care and Financial Services
Committee on Oversight and Accountability
2157 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman McClain:

The Commercial Real Estate Finance Council ("CREFC") appreciates the opportunity to contribute its views on the commercial real estate market.

Introduction and Summary

CREFC comprises over 400 institutional members representing U.S. commercial and multifamily real estate investors, lenders (banks, non-bank lenders, insurance companies, fixed income investors in CRE securities, and securitized lenders), and service providers – a market with almost $6 trillion of commercial real estate and multifamily ("CRE") debt outstanding. CREFC, which is celebrating its 30th Anniversary in 2024, is committed to promoting strong and liquid debt markets across CRE platforms.

Liquidity in the debt markets and CRE finance is essential in the development and operation of the properties where all Americans live, work, shop, and spend their free time. Our principal functions include ensuring that the CRE markets have prudent levels of liquidity, establishing and maintaining industry market standards and best practices, facilitating the free and open flow of market information, and delivering high caliber educational programming for all participants in the CRE lending community.

One of our core missions is to foster the efficient and sustainable operation of CRE securitizations. To this end, we have collaborated closely with policymakers to educate and inform legislative and regulatory actions to help optimize market standards and regulations and ensure that CRE debt liquidity remains available to this vital component of the U.S. economy.

Today, CRE lenders, owners/borrowers, and CRE-related bond investors (CMBS and CRE CLOs) face significant market challenges, including higher benchmark interest rates and thus mortgage rates (primarily Term SOFR and the 10-year Treasury), shifts in CRE and multifamily property uses and demand, and the uncertainly a post-COVID environment has created in sectors like office assets. To the good, despite these challenges, the market has improved since 2023. Lenders are still making loans, and the industry is addressing the challenges market-by-market and property-by-property. But challenges remain, and overly burdensome regulation could counter small improvements in the sector.

While 50% of CRE loans reside on bank balance sheets, the private-label and agency CMBS securitization markets, life insurance companies, debt funds, and other nonbanks provide added financial diversity that supports the sector well. During this uncertain time, it is crucial that overbroad regulatory action not hinder credit availability to the sector. On the federal level, CREFC has expressed serious concerns with the proposed Basel Endgame Capital proposal and its impact on the availability on CRE debt liquidity.

We highlight that the banking community is responsible for 50% of all CRE lending. Any increased burden on banks' ability to lend to CRE would prove challenging for the markets. Furthermore, we have commented on SEC proposals that could further constrain credit availability in the capital markets. We are encouraged that (a) the banking regulators have indicated the Basel proposal will be changed and that (b) the SEC has more appropriately tailored some of their proposals.

Even with these adjustments, CREFC and its members remain concerned that imprudent policy could amplify market distress by constraining the availability of prudent capital. Beyond the federal arena, we are also encouraged that many state and local governments are working to confront issues unique to their community through zoning policy, enabling office conversions, and collaboration between business leaders and policymakers.

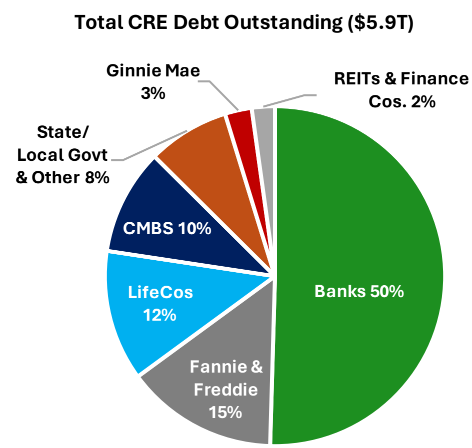
Below, we cover the market issues and hurdles in more detail, and CREFC and the entire CRE industry stand ready to assist lawmakers, regulators, and policymakers in understanding and confronting the challenges ahead.

CRE Market Overview and Update

Lending Composition: As shown in the table below[1], the $5.9 trillion CRE sector is supported by a variety of capital sources. Banks hold 50% of all CRE loans and are followed by Fannie Mae, Freddie Mac, and Ginnie Mae at 18%, life companies at 12%, CMBS at 10%, state and local governments at 8%, and REITs and finance companies at 2%.

In agency and private-label Commercial Mortgage-Backed Securities (CMBS), the loans are packaged and sold as bonds. Private-label CMBS include all property types and are sold to sophisticated institutional investors through registered and non-registered offerings. Life insurance companies also are significant lenders and holders of CRE debt, and a growing number of nonbank lenders raise private and public capital to make CRE loans, many of them secured by commercial properties undergoing a change in use.

CRE Debt Outstanding (billions)	4Q 2023
Banks	$2,971
Fannie & Freddie	$852
Life Cos.	$733
CMBS	$593
State/ Local Govt & Other	$459
Ginnie Mae	$150
REITs & Finance Cos.	$129
Total	**$5,888**



Macro Factors Impacting CRE

Rising benchmark and mortgage rates and considerable uncertainty related to property valuations pose risks to the sector.

- Like previous market downturns, this one has its own unique characteristics – mainly a component of the distress is tied to a global pandemic and its aftermath.

[1] Source: Federal Reserve

- The pandemic's impact on real estate included work-from-home regimes, heightened e-commerce, and actions taken by the federal government to support individuals and businesses during COVID.

- What is more, persistent elevated levels of inflation have forced the Federal Reserve to raise the Fed Funds rate to the 5.0% - 5.25% range. As such, mortgage rates on commercial real estate assets are now in the 7% to 8% range, which often causes interest expense to exceed operating cash flow from the underlying property, putting pressure on owners/borrowers. If this persists, it may cause loan defaults to increase, putting pressure on the lenders and their ability to satisfy minimum capital requirements.

CRE Loan Distress Remains Subdued

From a distressed loan perspective, loan performance remains remarkably resilient, holding well below pandemic and Great Financial Crisis highs. The CMBS market's significant transparency allows for important insights into CRE/multifamily asset-level performance, trends, and metrics extent at the property level.

As of March 2024, 4.67% of CMBS loans were delinquent (see chart below), well below the June 2020 pandemic peak. The overall delinquency rate has been in the mid-4% area since July 2023. From the snapshot below, office loans currently have the highest percentage of distress with industrial loans performing extremely well with a delinquency rate of just 0.47%.

CMBS Delinquency	**Mar-24**	**Feb-24**	**Jan-24**	**Mar-23**	**Mar-22**	**Mar-21**	**Jun-20**
Hotel	5.45%	5.45%	5.46%	4.41%	6.86%	15.91%	24.30%
Retail	5.56%	6.03%	6.27%	6.23%	7.47%	10.88%	18.04%
Multifamily	1.84%	1.81%	1.91%	1.91%	1.51%	3.13%	3.28%
Industrial	0.47%	0.43%	0.40%	0.37%	0.48%	0.73%	1.56%
Office	6.58%	6.63%	6.30%	2.61%	1.65%	2.23%	2.65%
All	**4.67%**	**4.71%**	**4.66%**	**3.09%**	**3.73%**	**6.58%**	**10.32%**

Bank and Life Insurance company Q4 2023 delinquency rates are even lower than CMBS levels at just 1.31% and 0.36%, respectively. And despite the 2023 regional bank turmoil and negative outlooks on the office sector, banks have strong reserves ahead of potential losses.[2] However, the longer benchmark interest rates remain high in comparison to recent levels, the greater is the risk of increased loan defaults and potential stress on the banking and financial sector.

CRE Lending Volume Down Sharply

Overall CRE lending volume fell sharply in 2023, just $429 billion, down 47% from the $816 billion in 2022 and a 51% decrease from 2021. Thus far, 2024 is showing some improvement. For example, total private-label CMBS issuance, as of April 19, is up 175% year-over-year to $21.3 billion from $7.8 billion.

[2] Telis Demos, *Banks Believe They Are Well-Prepared for Commercial Real Estate Fallout,* The Wall Street Journal, April 19, 2024, https://www.wsj.com/real-estate/commercial/banks-believe-they-are-well-prepared-for-commercial-real-estate-fallout-b34c6cbf (last visited April 29, 2024).

CREFC surveys its 55-member Board of Governors on a quarterly basis for their outlook on key market and economic issues. The ***CREFC BOG Sentiment Index*** aims to gauge quarter-to-quarter shifts in market conditions for the CRE finance market and the outlook for the future.

Overall, the First Quarter 2024 survey, conducted in April 2024, survey results reflected a more tempered outlook amid continued economic uncertainty. While there is a notable shift toward a more cautious outlook, this is balanced by strategic adjustments across our industry. The sector is navigating these uncertain times with a focus on adapting to market realities (high rates and declining property valuations in many property types, especially office) and today's regulatory environment.

A couple of metrics to note:

- **CRE Fundamentals:** Expectations for commercial real estate fundamentals are cautiously optimistic; 24% predict improvement over the next year, up from 15% in the previous quarter; 43% predict neutral; and 33% predict worsening.

- **Financing Demand:** Although still positive, there is a noticeable cooling in expectations for borrower demand for new financing, with 69% anticipating increased demand, down from 88% in the prior quarter.

- **Overall Sentiment:** The industry's overall sentiment appears to be stabilizing, with 84% of responses being positive or neutral, an increase from 81% in the prior quarter.

Regulatory Hurdles

As discussed above, capital market dynamics are a major driver of the current state of CRE. Additionally, higher operating costs, especially labor costs and insurance, continue to exert pressure on property owners.

The sticker shock of insurance premium increases, if insurance is even available, has become a major issue amid increasing losses due to the increase in severe storms and natural disasters. Beyond insurance price increases, lenders and borrowers must anticipate and agree to potentially significant policy changes over the life of the loan, which can be challenging amidst double-digit percentage annual premium increases.

Shifting to policy impacts, state and local governments are key drivers of many regulations that directly impact the real estate in their communities. Local zoning, building codes, city plans, property and other restrictions can impact a CRE market, in particular the ability to construct affordable housing and convert economically obsolete office buildings to residential use. At the federal level, tax policy and financial regulation are major drivers of behavior in the sector. Other important federal impacts come from infrastructure spending, environmental regulation, government leases, and specific program funding (e.g., energy conversion funds).

CREFC has commented on the federal banking regulator's Basel Capital Endgame proposal [3] and several SEC proposals impacting capital markets [4] and joins other industry trades on joint letters.[5]

By its own estimates, the Basel Proposal would raise capital requirements on target institutions by 16%, on average, which could have a profoundly negative impact on the availability of credit for commercial and multifamily real estate. This comes at an already challenging time for the provision of affordable housing, especially given today's elevated interest and thus mortgage rates. Implementing Basel without further consideration on its impact and efficacy, combined with a sectoral shift in the use of office space and today's elevated rate environment, this cost-raising proposal would inflict even further pain on the commercial real estate sector.

The Basel Proposal also would increase capital requirements for most exposures to securitizations, including CMBS and CRE collateralized loan obligations (CLOs). Securitization allows CRE risk to be distributed across the economy to sophisticated institutional investors who carefully allocate risk across their investment portfolios. Banks play a vital role in organizing these transactions and as market makers. Additionally, Credit Risk Retention rules established in the wake of the Global Financial Crisis require the issuer to retain some of the risk on their books to ensure alignment of interests.

We support a safe, sound, and resilient approach to banking regulation, including capital rules that ensure banks can withstand periods of financial stress. However, regulations in this area must be thoughtfully tailored to mitigate the actual risks to which a bank is exposed, not impose unnecessary constraints on the financial system or place unreasonable burdens indirectly on housing providers or other stakeholders.

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Thank you again for the opportunity to share our views on this important matter. Please feel free to reach out to me with any questions.

Sincerely,

Lisa Pendergast
Executive Director
Commercial Real Estate Finance Council

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[3] CRE Finance Council, Re: Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule (Docket ID OCC-2023-0008, Docket No. R-1813), (January 16, 2024), https://www.federalreserve.gov/SECRS/2024/February/20240229/R-1813/R-1813_011624_156853_512311686792_1.pdf

[4] CRE Finance Council, Re: Proposed Rule; Prohibition Against Conflicts of Interest in Certain Securitizations, Release No. 33-11151; File No. S7-01-23, Comment Letter on File No. S7-01-23 (March 27, 2023), https://www.sec.gov/comments/s7-01-23/s70123-20161721-330595.pdf

[5] Joint Real Estate Trade Groups, Re: Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule (Docket ID OCC-2023-0008, Docket No. R-1813), (January 16, 2024), https://www.federalreserve.gov/SECRS/2024/February/20240220/R-1813/R-1814_011624_157184_424419301588_1.pdf