THE FINANCIAL SERVICES ROUNDTABLE

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STATEMENT OF

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ON BEHALF OF

THE FINANCIAL SERVICES ROUNDTABLE

ON

COMMERCIAL REAL ESTATE: A CHICAGO PERSECTIVE ON CURRENT MARKET

CHALLENGES AND POSSIBLE RESPONSES

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

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Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee, I am William E. Askew, the Anthony T. Cluff Senior Policy Advisor to The Financial Services Roundtable ("the Roundtable"), on whose behalf I am appearing today. The Roundtable is a national trade association that represents 100 of the nation's largest integrated financial services companies. Our member companies provide banking, insurance and investment products and services to millions of American consumers. Several of our members are based in Illinois and many more have branches in the Chicago area.

Thank you for the opportunity to address the challenges facing the commercial real estate ("CRE") market. Commercial real estate is a five trillion dollar industry supporting twelve million jobs. The collapse of the credit market has impacted the CRE market, $6.7 trillion market at its peak and with $3.5 trillion in debt. Banks and commercial mortgage backed securities ("CMBS") are the largest sources of credit. Bank balance sheets hold $1.5 trillion of CRE loans, but as the underlying property assets securing these loans may have declined in value by as much as 40%, banks have reduced lending and investment activity for CRE. Annual CMBS issuance volume from 2001-2007 was on average $127 billion with a peak of $230 billion in 2007. As credit markets froze in 2008, so did the CMBS market, issuing $12 billion in 2008 and $1 billion in 2009. In Q1 2010 $309 million of CMBS has been issued, through one deal. Revitalizing the CMBS market is critical as $1.4 trillion in U.S. real estate loans are maturing between 2010 and 2014, and without a liquid secondary market, these loans will have trouble refinancing, putting more pressure on already depressed real estate valuations.

Given the importance of this industry to the economy, the Roundtable formed the Commercial Real Estate Coalition ("the Coalition"). The Coalition includes leading industry practitioners, such as securities and loan investors, borrowers and lenders, and representatives from industry trade associations, including the Commercial Real Estate Finance Council, International Council of Shopping Centers, National Association of Home Builders, National Association of Real Estate Investment Trusts, and the Real Estate Roundtable. Additionally, representatives of the Federal banking agencies were invited to attend meetings of the Coalition. The Coalition devoted much time and resources over the last several months to develop ideas to support and rehabilitate the commercial real estate industry.

At the outset, the Coalition set goals to guide its deliberations. These goals were: (1) restore confidence in the commercial real estate sector; (2) maintain regulatory compliance while balancing the need for additional lending; and (3) restart the commercial mortgage-backed securities market for long-term financing. After a dozen meetings and hours of debate, last month the Roundtable and the Coalition published a white paper entitled "Recapitalizing Commercial Real Estate: A Roadmap to Recovery", with 51 recommendations to meet these goals. The recommendations put forward in the white paper represent a holistic approach to rehabilitating the commercial real estate market. There is no one silver bullet to the problems facing the market. Given the size of the industry and scope of the problems, multiple actions are required. The full white paper is attached to this testimony, and I now will highlight a few of the key recommendations the Roundtable makes in the white paper.

1) Utilize Securitization to Restart the CMBS Market for Long-Term Financing

A major issue facing the industry is reviving the commercial mortgage backed securities ("CMBS") market. The overall commercial real estate market requires long term credit to function properly. The re-start of securitization will be key to economic recovery. Over the past two decades, the main secondary market vehicle for financing commercial real estate has been the CMBS market. In the period between 2001 and 2007, CMBS supplied 50 percent of all debt capital to the market; yet the CMBS market was illiquid between July 2008 and May 2009 and has yet to fully recover.

Today, there are few new securitized transactions in the market. In the absence of a CMBS market or other viable secondary market solutions, there is a financing void for commercial mortgage loans. Left unfilled, this lack of financing will further exacerbate downward pressure on commercial real estate values.

The Federal regulators can play a role in helping to revitalize the market. The Roundtable supports efforts to use securitization markets to sell commercial real estate assets taken over by regulators. In the wake of the savings and loan crisis, the Resolution Trust Corporation and the FDIC successfully used securitization as an effective exit strategy for assets seized from failed financial institutions. These securitizations helped to start the private sector CMBS market during that period. We encourage Federal banking agencies to take similar steps with commercial real estate assets acquired from failed financial institutions in the current crisis.

We also encourage policymakers to consider the unique characteristics of asset classes when adopting risk retention proposals and avoid one-size-fits-all legislation which may hurt borrowers and investors alike.

Additionally, our paper urges policymakers and regulators to coordinate reform measures, to avoid unintended consequences of disparate new rules creating further volatility and obstacles to recovery. For example, FAS 166 and 167 rules combined with a risk retention mandate and changes in risk based capital could virtually halt new securitizations. The Roundtable believes that the final interagency joint rule on FAS 166 and 167 should be re-examined and regulatory capital requirements should be adjusted appropriately to separate artificial accounting treatment from real credit risk (e.g. consolidation of an entire loan or pool of loans onto balance sheets for disclosure purposes does not change credit risk exposure). New retention mandates must also be examined in this context.

2) Extend TALF to Inject Liquidity and Confidence in the CMBS Market

The CMBS Term Asset-Backed Securities Loan Facility ("TALF") was developed to inject liquidity and confidence into the market by encouraging the securitization of privately originated loans in important asset classes to consumers and businesses. This program is set to expire and an extension is vital to the market. The program completed its first and only CMBS transaction with strong demand by investors driven by the conservative underwriting of the underlying collateral and the enhanced structure. The expected investment returns of the AAA tranche were large enough that investors declined to leverage those bonds with TALF; however, approximately 22% of the deal was financed using TALF funds.

TALF has been helpful in tightening spreads and encouraging certain new CMBS issuance. However, a crucial next step in market liquidity is the issuance of new multi-borrower pooled "conduit" CMBS (i.e. a diversified pool with 50 or more loans of all sizes) in order to provide the capacity necessary to satisfy the enormous volume of maturing loans and borrower demand.

There is currently insufficient market predictability for legacy CMBS lenders and issuers to assume the balance-sheet risk of aggregating pools of commercial loans to smaller property owners and issue larger, well diversified multi-borrower CMBS transactions. Such an aggregation may take six months or more to aggregate necessary collateral. While some institutions are beginning to contemplate commercial real estate loan originations with a securitization exit strategy, lenders in general are hesitant to take the interest rate and hedging risks to aggregate a portfolio of commercial loans. This is particularly true given the limited hedging vehicles available to protect balance sheets from the effects of spread volatility during the aggregation period. With this concern in mind, we recommend that Treasury utilize the TALF program as a direct and temporary solution to address the absence of a private-sector hedging tool. This approach would be temporary and phased out once a critical mass of deals are priced and can be referenced in the construction of a private hedging tool.

The new-issue CMBS TALF program is set to expire on June 30, 2010. However, some market participants believe that an extension may be in order if policymakers expand their definition of eligible collateral under TALF to include direct commercial mortgage loans and loans originated prior to July 1, 2008. To date, TALF collateral has been limited to Nationally Recognized Statistical Rating Organization ("NRSRO")-rated or Committee on Uniform Securities Identification Procedures ("CUSIP") securities of certain vintages and has excluded direct mortgages secured by real property assets. We understand that this restriction was intended to limit the program's exposure to real estate risk. Treasury may be able to use new guidelines to limit the program to acceptable loan structures, underwriting standards, and NRSRO-recommended credit-support levels to create a program to include an up-to-five year fully-callable financing vehicle for commercial loans. The existence of such long-term financing for commercial mortgages would limit the downside risk of making loans intended for securitization, even if the timeframe or ultimate execution of a private securitization is uncertain.

TALF will cease making loans collateralized by newly issued CMBS on June 30, 2010, and loans collateralized by all other types of TALF-eligible newly issued and legacy assets as of March 31, 2010, while the Federal Reserve Board of Governors has indicated that it will reserve judgment and continue to examine the facility.

The Roundtable recommends that decisions related to TALF should be clarified and support a transition to a vibrant private market for "conduit" CMBS deals needed for a CRE recover. TALF has been helpful, and based on current market conditions, the future of the program should be structured to reinforce the market if needed. In the meantime, policymakers should consider utilizing TALF as described above (hedging tool, whole loans, etc) in order to facilitate the transition to a private market. The Roundtable and Coalition members will continue to provide feedback to Treasury and the New York Federal Reserve on the TALF program to support the number and variety of transactions accessing the capital markets.

3) Eliminate Pro-Cyclical Accounting Practices

The economic crisis highlighted the impact of accounting standards on financial markets including commercial real estate. For example, the application of fair value accounting standards, which use near term exit pricing for asset valuation, proved to be both challenging and problematic in that period. Indeed, near-term exit pricing can differ vastly from the expected value of long-term assets and such procyclical actions have contributed to the slow recovery of the economy.

The Roundtable has several recommendations related to accounting standards. First, the Roundtable recommends that FASB evaluate pro-cyclical accounting standards and report to Congress how such standards might be modified in the current economy. This would include evaluation of fair value accounting, loan loss reserves, non-performing short-term loans, gain-on-sale, treatment of covered bonds, and deferred tax assets.

Additionally, the Roundtable asks for increased transparency and participation in the FASB rule making process. FASB should be subject to a formal notice and comment period similar to the Administrative Procedures Act ("APA") that is used by other self-regulatory organization like the Financial Industry Regulatory Authority ("FINRA"). Like FINRA, applying an APA-like process to FASB would increase transparency in the rule making process by requiring FASB to consider public comments and explain the reasoning behind its decisions.

Finally, the Roundtable encourages greater coordination between accounting policy and other regulatory and statutory change to avoid market dislocation, and to provide markets with certainty and confidence.

Conclusion

Thank you for the opportunity to present the recommendations of The Financial Services Roundtable and the Commercial Real Estate Coalition. We appreciate the Subcommittee’s attention and focus on the commercial real estate industry. We must act now to ensure that commercial real estate is not a deterrent to our economic recovery. The Roundtable and the Coalition look forward to working with you and the full Committee to assist and rehabilitate the industry.