

Snyder, Diane L

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From: Joel Fox [Joel_Fox@texanscu.org]
Sent: Thursday, May 26, 2005 4:41 PM
To: Regulatory Comments
Cc: John O'Shea
Subject: Joel Fox, Texas Commercial Capital Comments on Part 723 Member Business Loans

As Chief Credit Officer for a commercial lending CUSO, I am writing in response to the proposed change to the MBL rule regarding construction and development lending. The Board Action Memorandum dated March 25, 2005 stated that "NCUA believes an appropriate test for determining if a loan is a construction or development loan is whether the loan will be used to renovate or otherwise develop a property for an income producing purpose." While I agree that the rule should be changed to include property already owned by the member as opposed to the current definition of "property being acquired," the test for determining if a loan is a C&D loan as noted above is rather broad and vague. This definition will create problems for those credit unions who are already involved or are considering becoming involved in C&D lending. In fact, the definition as noted above does not adequately address the fact that C&D risks are completely different and separate from the type of property involved, whether it be owner-occupied or income-producing. C&D risks are not solely limited to renovating or developing a property to an income producing purpose.

Examples: A) Does a loan to a company for an addition to their existing warehouse fall under C&D? They are not building the addition for an income producing purpose but are simply expanding their storage space.
B) A member wishes to borrow \$1 Million to purchase an office building and will spend \$50,000 installing new carpet and painting the interior of the building. Does the entire loan fall into C&D as part of the loan will be used to "renovate" the property? Or is it just the \$50,000? Or none at all as the property was already used for an income producing purpose when the member purchased it? C) A member has a fully-amortizing loan on a residential rental property and requests an additional \$5,000 be added to his loan balance to be used to install a new roof on the property. Again, does the whole loan now become a C&D loan because the property is being renovated?

While the true issue regarding the portion of the NCUA MBL rule related to C&D lending is the cap on that type of lending, a credit union must be provided with a clear definition in order to plot a reasonable course for its C&D lending activities. Once a clear definition is established and can be relied upon, then the next issue to address is how practical is an arbitrary cap on C&D lending of 15% of net worth when other lenders with whom a credit union's MBL department will compete have C&D portfolios as high as 300% of capital? In fact, the limit on MBLs to one member or group of members is the same as the limit on C&D lending. In essence, regardless of the credit union's experience or policies, the credit union could make one loan to a member for a C&D purpose and be capped out of other C&D opportunities if that single loan reaches the credit union's limit for loans to a single member or group of associated members.

In setting guidelines for C&D lending, I believe that the NCUA could follow the FDIC's lead. Part 365 of the FDIC Rules and Regulations requires FDIC-supervised institutions to adopt and maintain policies that establish appropriate limits and standards for all real estate loans, including C&D loans. The Boards of those institutions are responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of their institution's efforts to manage and control risk. The level of risk-monitoring for C&D lending should be commensurate with the level of real estate activity and the nature and complexity of the institution's market.

Thus, a workable solution to appropriate risk-monitoring of C&D lending for credit unions could include the NCUA's review of a credit union's policies and procedures, experience, and activity in C&D lending and a subsequent determination of an appropriate cap for C&D lending for that credit union based on the factors noted above.

In conclusion, setting a vague definition of C&D lending does not address the true risks a credit union faces when entering the C&D arena. Construction and development lending is

truly region-specific, lender-specific, and risk-specific and can only be addressed adequately when approached in this manner.

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