CU Business Capital, LLC

August 25, 2008

Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Advanced Notice of Proposed Rulemaking for Part 723"

Dear Ms. Rupp:

CU Business Capital, LLC is pleased to comment on the NCUA proposed rulemaking for part 723.

Loan-to-Value Ratio Requirements and Unsecured MBLs

Unsecured limit of $100,000 should remain. Credit unions have an individual cap of 2.5% of a credit union's net worth and an overall limit of 10% of net worth at this point in the life cycle for business lending this limit is appropriate

80% restriction on fleet purchases should be removed. The regulation should include a limit based as a percent of net worth for fleet vehicles providing a level of safety and soundness. While it is true that fleet vehicles have a greater depreciation rate, the good borrowers typically have a plan to roll the vehicles out of the fleet in a short period of time and minimize their balance sheet risk. Each credit union should underwrite based on the overall risk and cash flow of the borrower's credit quality and at its discretion determines equity. However, as the regulation stands it places the credit union at a significant disadvantage for commercial vehicles.

Construction and development loan regulation should be specifically stated as **"80% of loan to cost (LTC)",** with an expectation that the borrower's equity in the project is minimum 20% of the **cost** of the project. The current language creates a fair amount of confusion between loan to value (LTV) and loan to cost (LTC). The following phrase should be changed *"market value at the time the loan is made"* and should be restated with the words market value removed and replaced with "*project cost at time the loan is made"*.
Construction lending from a safety and soundness perspective is best measured as cost of construction and overall cost of project. An attempt to measure from a market value perspective draws inferences that by nature are speculative and creates the riskiest part of the financing. Increasing the LTV to 80% adds to the credit risk and is not recommended, and term "loan to value" should not be used with construction projects.

Additionally, CU Business Capital suggests that the land component of the project should be defined as purchase price of the land plus any capital invested to improve the raw land, such as entitlements, etc. Appreciation of the land should be included in the project cost only if the borrower has owned the land for a period of greater than 24 months. An "as-is appraised value" can be used as a part of the cost. Both elements provide a safety and soundness approach precluding inflated values from construction projects.

The NCUA may also want to consider making a distinction between funding levels for soft cost and hard cost of a construction project. Soft costs are the intangible items such as architect fees, permits, legal costs, etc. These fees are typically paid in the first phase of construction project. Setting some guidance on percentage of soft cost that a loan may cover will add another level of safety as it will ensure that the borrower's equity is invested in the project before lender's funds are disbursed and that borrower has actual cash in the transaction as opposed to market value of the land only as its equity.

CU Experience Requirement

The two year experience does not adequately cover the breath of commercial lending available to credit unions. The regulation does not speak to whether the experience is underwriting experience or direct lender experience and there is a difference between the two. Some lenders come from more of a business development background and have not had formal commercial credit training even though they have been lending for well over two years.

It is recommended that the regulation speak to both sets of experiences and a minimum of three years maybe adequate for underwriting and five years for lenders. The credit union could utilize the services of a CUSO if similar years of experience are resident there.

Loan Participations

NCUA loan participation language would serve the movement well with a more structured format of the regulation. Loan participations are vitally important in providing diversification, reducing concentration risk, maintaining good member relationships, and overall asset liability management.

NCUA can achieve enhanced safety and soundness while removing the requirement to hold the minimum 10% as well as the restrictions on originator.

Safety and soundness is better accomplished by enhancing the regulatory framework to address the critical elements of loan participations in a manner that creates consistency, transparency, efficiency and enable loan participations to accomplish their role as a solid risk management tool. The current requirement for 10% and originator conditions does not have the same safety and soundness effect.

The regulation should be structured with a specific chapter within section 723 utilizing a format that addresses the critical characteristics of loan participations and enable the business lending practitioner to implement loan participations with greater clarity.

The following are key subject areas in which the loan participation regulation should be formatted. These topics are intended to suggest areas that a credit union is required to address and not intended to suggest that the regulators define specific variables:

1. <u>CU loan participation policy minimum content</u>
   a. The regulations should require a loan participation policy with a minimum content level specific to business lending. This element would enable a higher level of consistency for participations across the movement.
   b. Minimum content should include loan product types, geographic restrictions, industry restrictions, servicer due diligence, originator due diligence, underwriting standards, loan document review, participation agreement standards, funding and closing standards, annual review standards, payment and settlement standards, etc.

2. <u>Loan participation underwriting standards</u>
   a. The regulation should address minimum underwriting standards elements that should be reviewed by a purchasing credit union. This would ensure selling credit unions perform to a high standard before attempting to sell a loan.
   b. Standards should point to debt service coverage standards, loan to value, loan to cost, participation hold minimum and maximum, yield standards, product type, industry, geographic range, etc

3. <u>Loan participation agreement structure and terms</u>
   a. One of the most critical elements of any participation is the participation agreement. The regulation should identify basic elements of this agreement as this will achieve higher levels of safety.
   b. Standard documents should require that each loan has a formal agreement or master agreement, decision making power, warrants and representations, payment and settlement, loan default or delinquency management, etc

Again, these topics can see further refinement in an appropriate forum and are not all inclusive but intended to suggest that a broad framework will create effective risk management and greater flexibility.

Overall, loan participation is a critical tool for credit union asset liability management. The current regulation is trying to achieve safety and soundness by ensuring the originator has acted in the best interest of its participants, and the regulation tries to accomplish this by requiring the lead credit union to retain a small percentage of the loan and/or controlling who originated the loan. These two elements are not nearly as effective as establishing a regulatory framework as suggested above that encompasses a wider level of loan participation elements which forces consistency and transparency.

Structuring the participation regulation in such a manner would provide a stronger foundation for the credit union movement to capitalize on this very important risk management tool and eliminate much of the confusion.

Personal Guarantees

The current regulation only addresses the need for personal guarantees. However, enhancing the regulation to include a broad range of guarantees will enhance risk management and add flexibility to credit union movement business lending programs.

The RegFlex waiver has also created a sense of false security as enough emphasis is not placed on the qualitative elements of the guarantee being offered.
CU Business Capital believes that it is the borrower that should be evaluated for credit risk and determination as to applicability of a guarantee and not the credit union's CAMEL rating.

CU Business Capital would recommend the following:

- The RegFlex waiver related to personal guarantee should be eliminated. This should be replaced by precise requirements for loans that would determine the need for a personal guarantor such as borrowers' credit quality and sponsor strength.
- However, CUBC would suggest that focus on borrower strength with stated formula provides an enhanced level of risk mitigation as not all personal guarantees provide the regulations intended safety and soundness, irrespective of RegFlex status.

- Corporate Guarantees: With the addition of Limited Liability Companies (LLC's) many members have taken advantage of this efficient tax and liability management structure and moved assets into LLCs. The regulation should address the fact that accepting a corporate guarantee is an acceptable guarantee. Application of corporate guarantee to loans should see the same formula as spoken of above.

- Limited Guarantees and Deficiency Guarantees should also be included to support lending transactions where the quality of the borrower is of such quality that these types of guarantees enable the credit union to protect their asset and remain competitive. Again utilizing a formula approach would determine usage of such guarantees.

CU Business Capital thanks the NCUA for this opportunity to comment and make suggestions. This is a unique time in the credit union movement when these decisions can truly shape the growth and success of the movement.

Again thank you.

Respectfully,

Bert Bryan

Bert Bryan
President