

185 South State Street, Suite 201 Salt Lake City, UT 84111 (801)
364-4303 (801) 364-4495

April 12, 2006

Ms. Jennifer J. Johnson

Secretary

Board of Governors of the Federal Reserve System

20th Street and Constitution Avenue, NW

Washington, DC 20551

Attention: Docket No. OP-1248

Mr. Robert E. Feldman

Executive Secretary

Federal Deposit Insurance Corporation

550 17th Street, NW

Washington, DC 20429

Attention: Comments

Regulation Comments

Chief Counsel's Office

Office of Thrift Supervision

1700 G Street, NW

Washington, DC 20552

Attention: Docket No. 2006-01

Office of the Comptroller of the Currency

250 E Street, SW

Public Information Room

Mail Stop 1-5

Washington, DC 20219

Attention: Docket No. 06-01

Ladies and Gentlemen:

The Utah Bankers Association appreciates the opportunity to comment on the Agencies' Proposed Guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" (the "Guidance"), published in the January 13, 2006, issue of the Federal Register.

Summary of our Comments:

We welcome that portion of the Guidance that addresses the importance of maintaining effective internal controls and risk management practices to safeguard financial institutions from excessive credit exposure to the commercial real-estate ("CRE") sector. We respectfully suggest, however, in light of the matters more fully discussed below, that the financial-services industry would be better served if this guidance were substantially condensed and then distributed in the form of an Advisory

Letter setting forth recommended "Best Practices" in respect to commercial real-estate lending.

Based upon the collective experience of our members, we are not persuaded there is sufficient evidence to justify the Agencies imposing, on all insured institutions, a requirement that the institutions maintain additional capital to support concentrations of commercial real-estate loans. We therefore urge that formal rule-making on CRE exposures be deferred, pending the Agencies' conduct of a joint study of institutions' historical experience with problem credits and credit losses in the CRE sector. In addition, we question whether the subject matter concerned in the Guidance, and the objectives it seeks to achieve, are appropriate subjects of the formal rule-making under the Administrative Procedure Act the Agencies have chosen to employ.

The proposed Guidance oversimplifies CRE lending by treating it as a single, monolithic market sector, rather than the diverse collection of submarkets that are represented in the range of loans denominated as "commercial real estate" loans. Those submarkets are subject to, and are directly affected by, a broad range of differing economic influences that make it wholly inappropriate to treat all CRE credits identically.

Although neither the proposed Guidance nor the staff commentary published with the proposal explicitly refers to the Basel Capital Accord, it is readily apparent that adoption of the Guidance would represent a significant step toward imposing on all insured institutions the stricter capital standards the Accord mandates in respect to the CRE segment of institutions' loan portfolios. We believe that, especially in respect to those domestic financial institutions that have total assets of less than \$15 billion, subjecting them to requirements contained in the Accord would be neither necessary nor beneficial for the institutions, their depositors, or their shareholders.

A formal rule-making proceeding is not appropriate

We are puzzled by the Agencies' determination to promulgate this issuance under the formality of the Administrative Procedure Act. We are not aware that there is reliable evidence demonstrating widespread vulnerability of financial institutions to exposures from commercial real-estate lending.

It is further our view that the widely varying conditions existing in the respective real estate markets in which those institutions operate mean that, in those instances in which such vulnerabilities do occur, they are more likely to be successfully rectified by more tightly focused supervisory measures based upon, and tailored to address, the particular institution involved and the local conditions from which its problems arise.

If isolated instances of concern should arise from credit concentrations that have not been adequately addressed by the traditional supervision and examination processes, we suggest that the Agencies have available to them a wide range of other effective remedies, under the provisions of the Financial Institutions Supervisory Act, as amended by the Financial Institutions Regulatory Act, and under other enforcement statutes.

The Agencies should provide an empirical basis that demonstrates the need for the sort of regulation of commercial real-estate lending being proposed

If all insured financial institutions are to be made subject to mandatory requirements such as those set forth in the Guidance, we respectfully suggest it is incumbent upon the Agencies to make a reasonable showing that institutions with credit concentrations in the commercial real-estate sector thereby are subject to enhanced levels of risk. Extensions of credit of all types necessarily subject the lender to risk, yet no reliable information or data have been put forth by the Agencies to justify their proposed action in respect to CRE concentrations, but not to concentrations in, for example, credit-card lending, commercial and industrial loans, automobile loans, residential mortgage lending, loans to the technology sector, or other possible types of concentrations.

We therefore propose that any formal rule-making by the Agencies in respect to CRE concentrations be deferred, pending completion of a joint Inter-Agency study of the loss history of financial institutions over the past ten to fifteen years, to the

extent that losses were incurred by such institutions as a result of CRE lending. Such a study should examine, in addition to institutions' loss histories in CRE lending, the incidence of problem credits, including past-dues and non-performing loans, in CRE lending and in other lending areas.

The study should encompass a period of ten to fifteen years, in order to provide reasonable assurance that the underlying data represent activity over a full business cycle, and thus would present a balanced and realistic depiction of the economic risks of CRE lending, and a meaningful basis for comparison to the institutions' credit risks in other areas. Such a study necessarily would compare institutions' losses on CRE exposures with losses incurred over the same period in lending to other economic sectors.

It is only through empirical evidence such as would be produced by this kind of study that the Agencies reasonably can determine whether the burdens that, as a result of adoption of the Guidance, obviously would be imposed on all institutions, would be justified by the likelihood that lenders would be able to achieve material reductions in their CRE losses. Any such study also should examine how the impact of CRE lending varies with institutions' asset size and with the type or character of institution, e.g., how the impact differs among urban institutions, rural institutions, suburban institutions, community banks, institutions that are independently owned, those that are holding-company subsidiaries, etc.

The Guidance fails to recognize the utility and effectiveness of existing controls

We are concerned that the issuance of the proposed risk management principles would have the force, and, perhaps more important - and more unfortunately - the inflexibility, of agency regulations. We submit that such a "one size fits all" approach would impose an unnecessary and counterproductive mandate upon institutions within the community banking group.

Every community bank necessarily must be sensitive to, and must respond accordingly to, the credit needs of the community or communities it serves. We agree the board of directors of each institution, through its formulation and adoption of the institution's strategic direction, must determine how that institution will serve its community. Moreover, each board recognizes it must assess the risks inherent in the various roles the institution seeks to fulfill. There are a variety of methods and tools institutions may employ to mitigate risk, although the Guidance focuses primarily on additional capital and monitoring.

A vital aspect of effective monitoring is the role played by both the internal and external audit functions. The Guidance wholly fails to acknowledge the significant effects that have flowed from recent legislative and other measures designed to improve corporate recordkeeping, monitoring, and governance - including, for example, enactment of the Sarbanes-Oxley Act of 2002 - and the resulting changes in the role, and the enhanced vigor, of present-day internal and external audit functions. In a similar vein, boards of directors and

Audit Committees have been reinvigorated by the challenge of implementing the requirements of Sarbanes-Oxley.

The Guidance overemphasizes institutions' vulnerability to commercial real estate.

While we share the Agencies' concern for the maintenance of safety and soundness in the operations of insured financial institutions, we believe the proposed Guidance unreasonably exaggerates the potential exposure of those institutions to weaknesses in the commercial real-estate sector.

It is generally recognized, for example, that the recession of 1989-90 resulted in the failure of a number of financial institutions, both large institutions and community banks, which held significant concentrations of real estate loans. It is also generally recognized the collapse of the real estate industry during that period was due in large measure to significant changes that had been enacted in federal tax laws in 1986, which resulted, among other things, in the reduction or complete abolition of substantial tax benefits that previously had been available to investors in commercial real estate projects.

These problems were compounded by the number of lending institutions that exercised little if any prudent judgment in extending credit to the commercial real estate sector. A great many of the failures that occurred were among institutions that made loans with grossly excessive LTVs, often on a non-recourse basis, and often for projects that had not yet found tenants and that therefore offered sources of repayment that, at best, were speculative.

We are unaware, however, of any financial-institution failure over the past decade that has been attributable to a concentration of credit in real estate or in any other economic sector. To the contrary, it is our understanding that the principal underlying causes of bank failures over the past fourteen years have been fraud, abuse, or other unlawful conduct, on the part of bank management and, on occasion, bank customers.

Such deliberate wrongful conduct would be neither deterred nor prevented by the Guidance or by any other supervisory measure. If there should be a threat to the safety or soundness of any financial institution that arises from weakness in real estate markets, it is our view that the best way to create an effective safeguard against such threats would be by seeking to ensure, through traditional supervisory processes, that every institution has in place, and consistently makes use of, effective management supervision, reliable internal controls, including reporting and monitoring mechanisms, and effective credit-analysis and underwriting processes.

We believe, in addition, that the proposed Guidance greatly oversimplifies the CRE sector by treating "commercial real estate" as a single, monolithic market sector, when in fact it consists of a diverse range of numerous sub-markets that are driven by a wide array of varying economic and other activities.

A commercial real estate loan is any loan secured by real estate and for which the primary source of repayment is to be income

produced by that real estate, whether through lease revenues or sale of the property.

CRE thus encompasses loans to acquire raw land and to acquire, and/or construct, facilities as diverse as multifamily housing, strip shopping centers, shopping malls, industrial parks, manufacturing facilities, agricultural production facilities, properties used for bulk storage, warehousing, and transportation, professional office space, hotels, motels, resort properties, golf courses, and amusement parks, any and all of which may be situated in urban, suburban, exurban, or rural environments. The economic cycles of the commercial establishments associated with these properties vary tremendously, in part because the economic and market factors that determine the levels of their respective business activities, and that thereby can determine the fact, or the degree, of their economic success - and thus their ability to service their real-estate debt - also vary enormously.

One might infer from the proposed Guidance, and the commentary published with it, that repayment of all CRE loans is collateral-dependent, but our member bankers can assure you that that is far from the case. Under existing Agency guidelines, and at the insistence of the Agencies, institutions that engage in CRE lending typically evaluate every proposed loan, and every proposed obligor, individually. Evaluation of the borrower's financial capacity, including cash-flow analysis to establish the borrower's ability to service the debt, is in every case an integral element of the underwriting process. So, also, is evaluation of the financial capacity of any guarantor(s).

The proposed Guidance wholly fails to take account of the wide variety of factors that can and do serve to mitigate the risks of CRE lending for institutions that customarily employ careful credit analysis and proper underwriting as part of their credit culture. Such risk mitigants for any individual loan may include, for example, a high ratio of collateral value to loan amount, the presence of creditworthy guarantors with sources of repayment that are independent of the borrower and of the borrower's financial condition, and commitments from creditworthy tenants who occupy, or will occupy, the security property. The Guidance, moreover, contains no provision that would allow lenders to consider such important factors as the occupancy level of leased commercial property, the financial capacity of tenants occupying the property, and diversification among the tenants.

All these circumstances, in our view, make it wholly unrealistic and inappropriate for supervisory authorities to treat CRE lending as though all the obligors whose indebtedness falls within that category should be expected to experience uniform financial or business success, such that their overall indebtedness consistently will perform - or fail to perform - on a uniform basis. The various segments, or submarkets, that are subsumed under the category "commercial real estate" are, we submit, far too diverse in their activities, and too divergent in the operating results that they achieve, and in the conditions that influence those results, to warrant painting all such extensions of credit with the broad brush embodied in the Guidance.

Finally, the Guidance entirely overlooks the role of the secondary markets that allow financial institutions to manage or reduce their CRE exposure through sales of such loans, either on a stand-alone basis or

in securitized form. Secondary markets tend to be particularly useful for institutions holding fixed-rate CRE loans and those that hold loans on multifamily housing

The "threshold" levels of commercial real-estate concentrations proposed in the Guidance, which would necessitate corrective measures, are unrealistically low

The proposed Guidance would impose "heightened risk management practices" on any institution that has either (1) total reported loans for construction, land development, and other land that equal or exceed one hundred percent (100%) of the institution's total capital, or (2) total reported loans secured by multifamily and nonfarm, nonresidential properties, together with loans for construction, land development, and other land, that equal or exceed three hundred percent (300%) of total capital.

We believe that these thresholds are not commensurate with the levels of actual risk for institutions that adhere to the Agencies' existing regulations and guidelines on real-estate lending, and that employ careful and consistent credit analysis and underwriting standards that are appropriately based upon knowledge of the real-estate markets in which the institution, and its borrowers, operate. Since these are loans that are secured by tangible, hard collateral, we believe that, at least in the absence of empirical evidence that substantiates the utility of the proposed thresholds, higher levels of CRE exposure should be permitted before institutions would be subject to additional requirements as a result of such exposure.

It is our understanding that the FDIC, in its quarterly analysis of Call Reports during 2005, has acknowledged that past-due and otherwise troubled loans in the portfolios of insured financial institutions are at record low levels. We recognize that, in isolated instances, some institutions undoubtedly have experienced weaknesses in their loan portfolios - including credit-quality issues among their commercial real-estate loans - but such problems historically, and, we believe, appropriately, have been dealt with through the examination process and other traditional supervisory processes.

The extension to community banks of requirements such as those embodied in the Basel Accord is, we submit, unwarranted and would impose unneeded burdens on these institutions. Rather, if particular credit concerns arise in specific geographic areas, or with respect to particular types of commercial real-estate loans, those concerns, we believe, would best be addressed through the process of focused horizontal examinations.

Conclusion

It is not our intention to deny or disregard the risks faced by financial institutions that engage to a significant degree in lending to the commercial real-estate sector. We recognize and acknowledge that credit concentrations can impair and impede safe and sound operation and are a proper subject of supervisory concern. At the same

time, the characteristics of commercial real-estate markets vary widely throughout the nation, and management of the risks attendant upon extending credit in those markets is particularly dependent upon thorough knowledge and understanding of, and experience in, those markets, as well as knowledge of the businesses and individuals that do business in them.

For financial institutions that make use of their knowledge of the markets they serve, and that exercise care to maintain effective management supervision, internal controls, and underwriting standards, adoption of the proposed Guidance, we submit, would produce little, if any, benefit. For institutions that subject themselves to enhanced real-estate risk by poor management, ignorance of - or inattention to - their markets, inadequate credit analysis, or other undesirable practices, such weaknesses would more properly, and more effectively, be rectified through the traditional supervisory and examination process.

The proposed Guidance, therefore, in our view, would impose considerable burdens on financial institutions in order to ameliorate risks that, according to all reliable indicators, nearly all of those institutions, and the regulatory authorities having jurisdiction over them, have successfully managed with the supervisory mechanisms, and the management resources and tools, presently available. By failing to recognize and account for the widely differing levels of risk in lending to the CRE sector - and failing to allow lenders to take any account of those variances in risk - the proposed Guidance threatens to compound any vulnerabilities that might already exist within the sector by substantially curtailing the volume of credit that otherwise would be available to it.

As stated at the outset, we believe that some of the matters concerned in the Guidance would be beneficial as the subject matter of an Advisory Letter, but, for all of the reasons discussed herein, we strongly believe that more formal or more extensive regulatory measures are neither necessary nor appropriate to address any issues that may arise from financial institutions' lending exposures to the commercial real-estate sector.

Sincerely,

Howard Headlee
President