Massachusetts Bankers Association

April 13, 2006

Ms. Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve System **Attention: Docket No. OP-1248** 20th Street and Constitution Avenue, NW Washington, DC 20551 regs.comments@federalreserve.gov	Office of the Comptroller of the Currency **Attention: Docket No. 06-01** 250 E Street, SW Mailstop 1-5 Washington, DC 20219 regs.comments@occ.treas.gov
Mr. Robert E. Feldman Executive Secretary Federal Deposit Insurance Corporation **Attention: Comments** 550 17th Street, NW Washington, DC 20429 Comments@FDIC.gov	Regulation Comments Chief Counsel's Office Office of Thrift Supervision **Attention: No. 2005-56** 1700 G Street, NW Washington, DC 20552 regs.comments@ots.treas.gov

To Whom It May Concern:

On behalf of our 210 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the proposed guidance entitled Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices (Guidance). Many of our community bank members have been actively engaged in commercial real estate (CRE) lending for years. We strongly believe that the guidance is unnecessary, and if issued in its current form, will have a negative impact on the availability of credit in local communities throughout New England and the banking industry in Massachusetts.

According to the Guidance, the federal regulatory agencies are concerned that "some (emphasis added) institutions have high and increasing concentrations of commercial real estate loans on their balance sheets." Unfortunately, the response of the agencies to these concerns about the lending practices of certain institutions is to issue "one-size-fits-all" regulatory guidance that will have a negative impact on all institutions. In addition to the broad applicability of the Guidance, the proposal does not recognize factors such as local market conditions, the vast differences in risk between different types of commercial real estate loans, the number of borrowers, the size of the loans, or loan to value ratios for specific loans. If, as all of the agencies have suggested, there is "nothing new" in this guidance, what is the purpose of issuing it?

Our comments will focus on the following portions of the Guidance we find most problematic:

Identifying Institutions with "Concentrations in Commercial Real Estate"

The Agencies define a "concentration in commercial real estate lending" in the following manner:

(1) Total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or

Massachusetts Bankers Association, Inc.
73 Tremont Street, Suite 306
Boston, Massachusetts 02108-3906
Tel: 617-523-7595/Fax: 617-523-6373
http://www.massbankers.org

(2) Total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction, land development, and other land represent 300 percent or more of the institution's total capital.

This definition combines various types of commercial real estate, such as 1-4 family residential construction (including custom home contracts), loans made directly to consumers for the construction of new housing, multifamily property loans, along with exposures secured by raw land development and construction. Even loans to Real Estate Investment Trusts (REITs) are included. The definition also does not differentiate between high and low loan-to-value ratios, nor does it take into consideration portfolio diversification among borrowers or types of loans.

While the Guidance does exclude loans secured by owner-occupied properties from the definition, we are still concerned that the there is no clear differentiation between the risk of 1-4 family residential construction loans where the builder has a contract for the home or the loan is direct to a consumer versus truly speculative commercial development. Such construction to permanent financing is essentially a residential loan and therefore should be exempt from this guidance.

Similarly, multifamily housing is the principal housing stock in many local communities throughout the Northeast. This is particularly true in most urban areas, primarily due to land costs and zoning considerations. Many of these developments are basically residential properties without the risks of raw land development for example, and should not be included in the definition of commercial real estate. Minimally, these types of loans, with reduced loan-to-value ratios (i.e. 70%) or established cash flow patterns, should be exempt from any regulatory concern.

Without increasing capital or subjecting themselves to additional regulatory burden, the Guidance effectively limits CRE lending growth at many institutions in Massachusetts and New England. It should be noted that the agencies already have the regulatory tools to address CRE concentration issues at individual institutions or in specific areas of the country. As the agencies are aware, CRE markets vary greatly from region to region, and even within a particular state. We have been told that the agencies are particularly concerned with fast-growing areas with vast amounts of land development and construction. If that is the case, we believe that the agencies should focus more attention on local market conditions and the overall condition of individual institutions than imposing generic thresholds on all banks.

Increased Regulatory Burden

The guidance proscribes a series of risk management principles for institutions where a CRE concentration (as defined) is present. While many banks may have some or all of these procedures in place, others will be cost-prohibitive and overwhelming for many community banks. There does not appear to be any attempt to tailor the Guidance to the size of an institution or the risk in its portfolio. In fact, it appears that smaller institutions will be required to meet the same standards as the largest banks in the country. This will undoubtedly force some community banks from the CRE lending business altogether, potentially threatening their financial viability. It is interesting to note that credit unions, which have been aggressively courting large commercial real estate loans, and in some cases stealing them from banks, will not be subject to this guidance.

In addition, we are concerned that banks will face an added burden of preparing documentation for examiners simply to prove that an institution has the proper risk management practices in place. It appears from the proposal, and from our conversations with member banks that have recently gone through the exam process, that the Guidance will be applied vigorously to all institutions, regardless of size, portfolio risk, or risk management practices in place. Anecdotal evidence suggests that examiners are already quoting these "new rules" to justify extreme regulatory mandates. We strongly disagree with this "one-size-fits-all" approach.

Impact on Community Development Lending

In an era when unregulated mortgage companies and non-bank lenders have squeezed banks out of the residential lending market, prudent lending in commercial real estate has been a key service and revenue source for banks, particularly in the Northeast. Community banks play an essential role in providing credit for community development and revitalization efforts in areas where few other sources of credit may exist. Local elected officials many times rely on local institutions to provide this financing, and local banks work hard to fulfill their requirements under the Community Reinvestment Act for community development and small business lending.

We believe the Guidance will disproportionately affect urban areas, since it exempts many of the loans made in rural areas from the threshold calculations. Many times, community banks are the only source of credit available to small business owners in these areas. Forcing banks to reduce or abandon CRE lending in these neighborhoods could inhibit revitalization efforts or force business owners to turn to more expensive forms of credit.

The Guidance also appears to inhibit a lender’s ability to make loans that do not meet strict underwriting criteria. We question whether the agencies have analyzed the economic impact of discouraging banks from making loans to businesses not considered the absolute best credit risks. Local lenders are in the best position to determine the viability of a particular business customer, and reducing an institution’s flexibility to serve its local business community will mean that many middle-market business will not have the opportunity to grow.

Increased Capital

We are extremely concerned with the section of the Guidance that recommends increased capital levels for all banks with “defined” CRE concentrations. In reading the proposal, we believe that it encourages examiners to require additional capital in the event they identify a concentration in CRE lending. The language is vague, and important factors such as the management of the CRE portfolio, the asset mix of the portfolio, existing reserves, and recent losses, are not specifically taken into consideration.

The possibility of an additional capital requirement will place a serious burden on the industry in Massachusetts. Approximately 70 percent of the banks in Massachusetts are mutual institutions, which are unable to turn to the market to raise capital. If the Guidance is issued as currently written, many of these institutions will be forced to greatly reduce their CRE lending in the future.

In defending this proposal, several regulatory agencies have argued that the 100%/300% capital tests are not strict caps by merely pressure points with which to monitor levels of concentration. As we’ve already stated, the fact that field examiners have already cited these “caps” as issues of concern makes it clear that these thresholds will be “carved in stone”. Therefore, we believe the strict 100%/300% tests should be dropped from further consideration.

Consistency with Basel I-A /Basel II

The proposed guidance comes at a time when the agencies are also proposing changes to the capital system through the Basel I-A process. As you know, loans made for the acquisition, development, and construction (ADC) of commercial property are currently subject to 100 percent risk weighting. However, the Basel I-A ANPR proposes increasing the risk weighting above 100 percent unless certain conditions are met.

We would assert that what is deemed "appropriate" for capital should be reviewed from a macro-level, in which risk-weighted capital at the bank is assessed in its entirety – not just for one narrow classification of assets as proposed in this Guidance. As the agencies implement the new capital standards over the next several years, we hope that there will be increased coordination to avoid duplicative and/or contradictory regulations in this area.

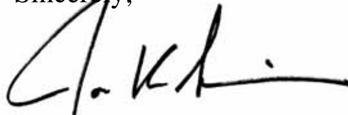
Conclusion

CRE lending is an important business for many banks in Massachusetts. Community banks in our state play an essential role in creating local economic growth by providing credit to small and medium-sized businesses for construction and land development. In addition, in a state where affordable housing is scarce, CRE lending by community banks helps create new housing units in many cities and towns.

If the guidance is issued in its current form, it will place a significant regulatory burden on these institutions, possibly forcing them to curtail or suspend their CRE lending activity. This would be devastating to local communities that rely on local banks to help revitalize downtown areas, create new housing, and finance business expansion. As such, this formal guidance should be dropped from consideration or dramatically altered and reissued for comment.

Thank you again for the opportunity to comment on the Guidance. If you need any additional information, please feel free to contact me at (617) 523-7595.

Sincerely,



Jon K. Skarin
Director,
Federal Regulatory & Legislative Policy