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Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn: 2006-01

RE: Docket No. 2006-01 – Proposed Interagency Guidance – Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices

Dear Sir or Madam:

First Federal Bank of California (FFB) recognizes the Agencies' concerns regarding Concentrations in Commercial Real Estate and appreciates the opportunity to comment on the proposed guidance.

FFB agrees that additional monitoring and risk management practices are appropriate when an institution has <u>any</u> large concentration in its loan portfolio. However, risk management systems should bear some relationship to the attributes within a portfolio. Management systems should consider the quality of initial underwriting and monitoring processes as well as economic and interest rate environments. The Proposal's glaring lack of commentary or guidance on credit characteristics or loan portfolio seasoning, two key components of risk analysis, is perplexing. Not only do institutions accept different levels of risk in underwriting and structuring a transaction, the composition and complexity of loans that meet the proposed definition of Commercial Real Estate varies from one institution to another. A one size fits all approach is neither appropriate nor effective when considering the myriad of differences in risk levels from one institution to another.

The following comments are a response to the items on which the Agencies specifically requested comment, and additional topics for which FFB felt comment was necessary.

Requested Comments

Scope of CRE Definition – The definition of Commercial Real Estate is very broad and includes transactions of varying risk levels. Construction and land development loans typically are higher risk transactions and, as noted in the following section, are distinguished in the Guidance. However, the definition also includes nonfarm nonresidential properties and multifamily properties without distinguishing the risk levels between the two types of properties. FFB believes that the inclusion of multifamily loans in the definition of Commercial Real Estate is not appropriate as proposed. When compared to multifamily loans, nonfarm nonresidential properties are typically more susceptible to economic changes, require specific expertise to lease and manage, and have less adaptability to market changes due to longer term leases. The Agencies have acknowledged this in their risk based capital calculations as multi-family properties that maintain specific debt coverage ratios and loan to values are risk weighted at 50%. This has also been recognized by current limitations on commercial real estate which provide for a limit of 400% of capital for nonresidential real estate, and no specific limit for residential real estate, including multifamily property-secured loans.

Multifamily loans not only contain inherently less risk than nonfarm nonresidential properties, but the ability to lend on these properties provides capital to supply housing for those who cannot afford home ownership. As an OTS chartered institution, our primary contribution to the economy, and service to consumers, is to provide financing for residential properties. By including multifamily loans in the definition of commercial real estate, which is then subject to the proposed 300% capital concentration threshold, an institution's ability to provide such loans will be diminished. Ultimately this could negatively impact the availability of affordable housing. In addition, including multifamily loans within the definition of commercial real estate, when calculating the 300% capital limitation, and applying this on a retroactive basis without analyzing an institution's risk profile, is counter to the historic purpose of the savings and loan charter and places savings and loans at a competitive disadvantage. This Guidance unilaterally favors commercial banks that have historically had low concentrations of multifamily product due to their charters.

FFB **strongly** encourages the Agencies to exclude multifamily loans from the definition of Commercial Real Estate.

If the final Guidance ultimately includes multifamily loans in the definition of commercial real estate the Agencies are encouraged to exclude multifamily loans which meet the requirements for 50% risk weighting from the definition.

Alternatively, the Agencies should provide an additional threshold as a higher percentage of capital when including multifamily loans. For instance:

- Threshold (1) Construction, land development, and other land;
- Threshold (2) Nonfarm nonresidential properties and those included in threshold (1); and,
- Threshold (3) Multifamily properties and those included in threshold (2).

Threshold for Determining Elevated Concentration Risk – The threshold for determining concentration risk is two-fold. First, the Agencies establish a limit of 100% of capital for construction, land development and other land loans, and then a secondary test at 300% for all commercial real estate loans. These numbers appear arbitrary as the Guidance does not elaborate on how these limits were determined. Additionally, neither threshold considers the mix of an institution's portfolio. Depending on portfolio mix, the thresholds may to be too low, or even too high. For example, an institution which has a CRE portfolio containing 90% industrial space and 10% office space in one geographical local, but which meets the 300% of capital threshold, might well carry more risk than a well balanced portfolio which may exceed 300% of capital but which is spread between various property types, and includes various geographical areas. Clearly, one approach for each institution would not be warranted without consideration of other risk factors.

Additional Comments

Enforcement – The Agencies must be consistent in their enforcement of the provisions contained within the Guidance, and treat them as guidelines, not rules. This is a difficult task given the differences in risk tolerance and complexities between various institutions. However, a lack of consistency may put certain institutions at a competitive disadvantage by having to incur additional costs, which are ultimately passed on to the borrower, than another similarly situated institution. The Guidance should address how the Agencies propose that they will supervise the equal application of this Guidance, and should contain each Agency's examination procedures for the equal application of this Guidance.

Risk Levels – Risk levels vary from one institution to another and loans are priced according to the risk perceived by that institution. To require an institution with a lower risk profile to incur additional costs than that of a competitor with a higher risk profile creates a competitive imbalance and ultimately hurts the consumer. The Agencies need to consider a risk based approach to the Guidance rather than one size fits all arbitrary thresholds.

Capital Levels – The Guidance provides a broad and vague call for higher capital levels for institutions with CRE concentrations. We believe that the existing risk based capital standard is the appropriate regimen for determining capital adequacy. Accordingly, any

regulatory concern with respect to concentration issues should be addressed within that framework. The creation of an alternative or sub-regimen for capital adequacy that will be subjectively determined by examiners can only lead to disparate treatment for the regulated institutions.

Management Information Systems (MIS) – MIS systems, most notably at smaller institutions, may lack the sophistication to accommodate many of the suggested items within the Guidance relating to portfolio risk management. Many reports and tracking systems will need to be created utilizing off the shelf spreadsheets and word processing programs. The costs to create and maintain these reports will be considerable and put smaller institutions at a competitive disadvantage. Any requirement to track tenants of properties will be highly problematic, most notably on multi-tenant properties. Many systems do not contain data fields to accommodate multiple industry designations. Additionally, the time and cost to populate data fields for existing loans will be significant.

Again, thank you for the opportunity to comment on the Guidance and your consideration.

Best regards,

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