REGULATORY & HOUSING POLICY AREA

DAVID A. CROWE
Senior Staff Vice President

April 13, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments

Docket No. 06-01
Office of the Comptroller of the Currency
Public Information Room
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219

Docket No. OP-1248
Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-01

Re: Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices
71 FR 2309 (January 13, 2006)

Dear Sirs and Mesdames:

On behalf of the 225,000 member firms of the National Association of Home Builders (NAHB), I welcome the opportunity to respond to the proposed guidance (Proposal) issued jointly by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the

1201 15th Street, NW, Washington, DC 20005-2800
(202) 266-8383: (800) 368-5242 X8383: Fax: (202) 266-8426

Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS), collectively, the Agencies. The Proposal outlines the Agencies' supervisory expectations for a safe and sound commercial real estate (CRE) lending program, particularly as it relates to institutions with concentrations in CRE loans.

NAHB is a national trade association representing individuals and companies involved in the production of housing and related activities. Each year, NAHB's builder members construct about 80 percent of all new housing in America. NAHB's builder members are mostly small businesses with limited capital of their own. These small businesses depend almost entirely upon commercial banks and thrifts for housing production credit. Our surveys show that 90 percent of all loans for residential land acquisition, development and construction (AD&C) come from commercial banks and thrifts. Consequently, the appropriate supervisory treatment for these types of loans is critical to the health of the home building industry.

If adopted, the Agencies will use the Proposal to identify institutions with commercial real estate loan concentrations that may be subject to greater supervisory scrutiny. The Agencies also will expect financial institutions to ensure that their risk management and capital levels comport with the terms of the Proposal.

NAHB requests that the Agencies consider refining the proposed classification scheme for determining the types of lending programs that would be subject to the Proposal. NAHB further suggests that the Agencies incorporate additional flexibility to the manner in which the guidance is implemented, particularly with regard to smaller financial institutions.

Background

In the Proposal, the Agencies describe their observations that some financial institutions have high and increasing concentrations of CRE loans on their balance sheets. The concern among the Agencies is that concentrations in CRE loans where repayment is primarily dependent on rental income or from the proceeds of the sale, refinancing or permanent financing of the property may expose institutions to unanticipated earnings and capital volatility due to adverse changes in the general CRE market. As a result of their concern, the Agencies issued the Proposal which, according to the Agencies, is intended to reinforce the existing Interagency Guidelines for Real Estate Lending Policies.

The Proposal creates a new definition of CRE loans to include exposures secured by raw land, land development and construction (including 1-4 family residential construction), multi-family property, and non-farm nonresidential property where the primary or a significant source of repayment is derived from rental income associated with the property (that is, loans for which 50 percent or more of the source of repayment comes from third party, non-affiliated, rental income) or the proceeds of the sale, refinancing, or permanent financing of the property. Loans to real estate investment trusts (REITs) and unsecured loans to developers that closely correlate to the inherent risk in CRE markets would also be considered CRE loans for purposes of this

Guidance. Loans secured by owner-occupied properties would be excluded from the CRE definition.

The Proposal instructs financial institutions with high CRE concentrations to have both heightened risk management practices and levels of capital that are higher than the regulatory minimums and appropriate to the risk in their CRE lending portfolios. A financial institution is considered to have a high CRE concentration, and thus subject to the Proposal, if it exceeds or is rapidly approaching the following thresholds:

- Total reported loans for construction, land development, and other land represent 100% or more of the institution's total capital; or
- Total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction, land development, and other land represent 300% or more of the institution's total capital.

NAHB Position

NAHB appreciates that the Agencies have initiated a dialogue on whether to modify the regulatory system in light of the robustness of specific sectors of the housing finance market, and we especially appreciate having the guidance proposed for public comment to give all stakeholders an opportunity to express their views.

NAHB supports a supervisory approach that directs financial institutions to have appropriate and prudent underwriting, portfolio management, and capital levels. NAHB's support for the Proposal is conditioned on the Agencies making every effort not to unnecessarily restrict the flow of housing production credit or raise housing credit costs. This will require a flexible approach in the supervisory process that is sensitive to significant differences among the different types of real estate loans as well as among financial institutions in terms of size, business plan and location.

NAHB believes that the Proposal would benefit from further refinement. In particular, NAHB notes that the definition of CRE included in the Proposal provides standardized, aggregate treatment for a wide assortment of loan types with diverse and possibly disparate risk profiles. For example, residential AD&C and multifamily mortgages with firm takeouts or established occupancy and cash flow history have significantly less risk than other types of CRE lending. In this regard, the proposal is at odds with the already established Interagency Guidelines for Real Estate Lending Policies, which differentiate among different types and risks of real estate loans. The proposed definition also conflicts with the Agencies' current capital framework which gives a preferred capital treatment for construction loans on pre-sold single family homes.

NAHB urges the Agencies to reevaluate their assumptions about the risks associated with residential AD&C lending activities. Without appropriate distinctions for the highly varied credit risk characteristics of the wide range of real estate-related assets in bank portfolios, the supervisory approach described in the Proposal would raise the amount of capital that financial

institutions must hold for many residential AD&C loans above current requirements, resulting in an inappropriate calibration of capital to risk on a bank's balance sheet. This treatment could discourage banks from engaging in residential AD&C lending activities because such lending carries the same supervisory stigma as other riskier lending activities. Alternatively, these institutions could decide to increase the interest rate and/or fees charged on residential AD&C loans to compensate for the additional capital and risk-management requirements described in the Proposal.

NAHB's analysis of time-series data from the OTS Thrift Financial Report shows that the charge-off rates for residential housing production loans are dramatically lower than for nonresidential real estate loans. In fact, the performance of single family home construction loans has been very close to the experience for home mortgages. Charge-off rates for multifamily mortgages are slightly higher than for single family construction loans, but significantly below rates on non-residential properties. We have attached a series of charts and a table with the underlying data that demonstrate the performance of residential AD&C loans and multifamily mortgages compared to other asset categories.

Given the empirical evidence presented in NAHB's analyses and the potentially adverse impact on the residential real estate market, NAHB believes that all residential AD&C loans should be excluded from the Proposal. Further, we urge the Agencies to exclude loans on multifamily properties with either firm takeouts or established cash flows with sufficient debt service coverage.

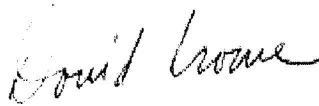
NAHB is also particularly concerned about the potentially adverse impact of the Proposal on small community lending institutions, which provide the financing for the bulk of NAHB's builder members. A Fall 2005 survey of NAHB single family builders found that nearly three-quarters of all respondents built less than 24 homes. Financing for these homes typically was provided by one primary local lender with whom the builder had done business for at least 10 years. The majority of builders reported that local service and trust of their lender are key factors in their lending relationship.

NAHB is concerned that, although not intended, the Proposal could cause small local institutions, most of which would reach the suggested thresholds with only a handful of loans, to cut back on their residential AD&C lending activities. Such an outcome would place smaller financial institutions at a severe competitive disadvantage vis-à-vis larger national lenders, who would enjoy much higher dollar thresholds under the Proposal. It also could have unnecessarily significant and negative repercussions on home builders as they would need to establish alternative lending relationships, a process that could be lengthy and costly to both builders and the housing market. NAHB members have vivid memories of the credit crunch of the early 1990s and do not want to risk a repeat of this painful time for both our industry and the economy. NAHB therefore requests that the Agencies' implement the Proposal in a manner that takes into account the size and complexity of the institution and its real estate-related loan portfolio.

Conclusion

NAHB endorses the Agencies' attempt to raise the awareness of risk in CRE lending and to point out increasing levels of concentration. Nevertheless, we request that the Agencies not overlook the superior loss performance of residential housing production and certain multifamily loans in their supervisory and risk classifications. Further, we caution that the Proposal could result in unintended competitive disadvantages for smaller institutions and urge the Agencies to recognize institution size and complexity in the final guidance. Thank you for your consideration and we invite you to call on us if we can provide additional information.

Sincerely,



David A. Crowe, Ph. D.
Senior Staff Vice President
Regulatory and Housing Policy

Attachment