June 20, 2005

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

VIA EMAIL: regcomments@ncua.gov

RE: Proposed Amendments to NCUA's Member Business Lending Rules and Construction and Development Loans

Dear Ms. Rupp:

The Minnesota Credit Union Network (Network), representing approximately 180 member credit unions in the State of Minnesota, respectfully offers the following comments to the National Credit Union Administration's (NCUA) proposed amendments regarding NCUA's member business lending rules and construction and development (C&D) loans. Specifically, NCUA is proposing to "revise the definition of 'construction or development loan' to include loans for renovating or developing property owned by a borrower for income-producing purposes."

The Network appreciates the opportunity to comment on NCUA's proposal and encourages NCUA to clarify and narrow its proposed definition to eliminate overly broad interpretation and application. While the Network understands the general concerns of NCUA with respect to speculative C&D loans, we believe the definition as proposed may have the unintended consequence of stifling credit union growth, limiting small business access to affordable lending sources, and restricting the granting of otherwise safe and sound C&D loans to existing and prospective members. The Network is particularly concerned with the potential interpretation and application of the terms "improve," "renovate" and "income-producing property" as set forth in the proposed rule. In addition, the Network encourages NCUA to reevaluate the 15% cap on a credit union's aggregate C&D loans under current rule. Finally, the Network encourages NCUA to clarify its September 25, 2003 NCUA opinion letter that addressed C&D loans (Letter No. 03-0430) so that NCUA examiners will interpret and apply the definition of C&D loans consistent with NCUA's concerns and intent.

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1. Meaning of “Improve,” “Renovate” and “Income-Producing Property”

The Network encourages NCUA to clarify and narrow the meaning of the terms “improve” and “renovate” under the proposed rule. The Network is concerned that such terms could be interpreted to include enhancements to property that are cosmetic or intended as normal maintenance and repairs, and not speculative or risky in nature. Cosmetic “improvements” or “renovations” would include improvements such as painting, wall coverings, carpet, and landscaping. Normal maintenance and repairs would include improvements and renovations such as replacing and repairing roofs, siding, parking lots and heating and cooling systems. Loans to accomplish these types of improvements and renovations should not be classified as C&D loans since a business generally needs to maintain and update its facility as part of its normal course of business. In fact, lending to a business that does not undertake such maintenance and updating is riskier than lending to a business that does undertake such activities.

The Network encourages NCUA to include as a covered C&D loan only those loans where improvements or renovations significantly increase the property value or are speculative in nature. The Network suggests that loans for improvements or renovations that are greater than 50% of the subject property’s current appraised value should be considered C&D loans under the rule. By applying such a threshold, the rule would strike a balance between a business owner’s need to maintain and update facilities with NCUA’s concerns over speculative and risky loans.

The Network also requests that NCUA clarify and limit the term “income-producing property” as used in the rule. It is not clear if this definition is limited to property that actually produces the income, such as an apartment building or leased-out offices that produce income through rent, or whether it also includes buildings that house income-producing businesses, such as stores or restaurants. The Network encourages NCUA to clarify and restrict this definition to include only those loans which are obtained to improve, renovate or otherwise develop property which will itself directly produce income.

Finally, the Network is concerned that the proposed rule does not clarify the amount of a loan that must be classified as a C&D loan if only a portion is intended for covered improvements or renovations. For example, if a loan is made to purchase an existing office building and only a portion of the loan is intended to improve or renovate the property, it is not clear from the proposed rule whether the entire loan should be classified as a C&D loan subject to the 15% cap, or only the portion designated for the improvements or renovations. Classifying the entire loan as a covered C&D loan penalizes both the credit union and the borrower when only a portion is truly an improvement or renovation covered by the rule. The Network encourages NCUA to clarify in the final rule that only that portion intended for covered improvements or renovations is considered a C&D loan.

2. Increasing 15% Cap

The Network encourages NCUA to reevaluate the 15% cap for C&D loans under its current and proposed rules and apply guidelines for C&D lending that are not subject to any specific cap. In the alternative, the Network encourages NCUA to increase the cap for C&D loans in light of the broader definition proposed and streamline the waiver process.

Under NCUA's current C&D rule, the aggregate of a credit union's C&D loans shall not exceed 15% of the credit union's reserves. In setting this cap in 1991, NCUA explained that it believed such a cap "reduces the overall exposure in the credit union" of speculative and risky loans. This one-size-fits all rule, however, penalizes credit unions with greater experience and sound policies, procedures and practices in C&D lending. Although NCUA permits a credit union to seek a waiver from the cap, the waiver process can be time-consuming, cumbersome and confusing, thus preventing the credit union from making C&D loans that are otherwise safe and sound during the waiver request process.

The Network encourages NCUA to eliminate the blanket 15% cap, and instead review a credit union's policies and procedures, experience, and activity in C&D lending and determine an appropriate cap for C&D lending for that credit union. In the alternative, in light of the broader C&D definition proposed which would reclassify and include more loans within a credit union's C&D cap, the Network suggests that NCUA increase the current 15% C&D cap and streamline the waiver process to account for a credit union's experience and history in C&D lending.

3. Clarification of September 2003 NCUA Opinion Letter

Finally, the Network encourages NCUA to clarify its earlier September 25, 2003 opinion letter concerning C&D Member Business Loans (MBL) to ensure that NCUA examiners interpret and apply the definition of C&D loan consistent with NCUA's concerns and intent.

In the September 2003 opinion letter, NCUA seems to conclude that a loan is a covered C&D loan where "the borrower will use the loan proceeds towards the renovation of a commercial building", even if the borrower "already owns [the building] that it occupies [and] wants to refinance its current mortgage and borrow enough new money to renovate the building which it will continue to occupy." (See NCUA's answer to question 7 in the September 2003 opinion letter.) This opinion appears to go beyond the C&D loan definition contained in current rule which, as recognized by NCUA in its proposed rule, excludes a loan to a borrower who already owns or has rights to a property. Moreover, the opinion letter makes no mention of the type and significance of the renovation at issue, which the Network contends is critical to the appropriate definition of a covered C&D loan. Therefore, the Network requests that NCUA make clear in its final rule that this opinion letter should not be relied upon by credit unions and examiners in determining the appropriate classification of C&D loans. Rather, credit unions and

examiners should look solely to the clarified definition contained in the final rule in making such determinations. Pending issuance of a final rule, the Network requests that NCUA instruct examiners to rely solely upon current rule in their examinations, not the 2003 opinion letter.

In light of the number of clarifications and revisions the Network believes should be implemented in a final rule, the Network asks NCUA to issue a revised proposed rule on the definition of C&D loan taking into consideration comments received on this proposal, and solicit additional comments on the revised rule before issuing a final rule.

Again, the Network wishes to thank NCUA for the opportunity to comment on its proposed C&D rule. If you have any further questions, please contact me at (952)954-3071.

Thank you for your consideration of the Network's comments.

Sincerely,

Theresa H. Tostengard
General Counsel