March 24, 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

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

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

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

Dear Sir or Madam:

State regulators are strong advocates for a safe and sound banking system that serves and protects the residents of our states and meets the economic development needs of local communities. We recognize the risks that concentrations in commercial real estate can pose and the importance of banks exercising strong risk management practices utilizing appropriate analytic and monitoring tools. We have, however, several concerns regarding the proposal. These are:

- *The proposed guidance does not recognize that risk varies among CRE sub-markets.*
- *The proposed guidance would place an especially heavy burden on community banks.*
- *The proposed guidance could impair banking industry competitiveness in commercial real estate lending.*
- *Supervisory tools already exist, and are being used to deal with unsafe banking practices, such as unsound concentrations, in any line of bank business.*

The commercial real estate market is not homogeneous. There are a multitude of sub-markets within the CRE category that are characterized by varying levels of risk. We note that the proposed guidance does not differentiate among the assorted-risk sub-markets in the CRE sector. It is important to recognize that many bank lenders exercise risk mitigation procedures by limiting their involvement in higher risk

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aspects of the CRE market, and by placing limitations such as lending limits on construction and development lenders, imposing individual builder limits, placing aggregate limits on certain types of lending, and imposing cash flow and other financial requirements on borrowers.

We are concerned with the unnecessary burden several of the requirements in the guidance will place on all institutions, but especially community banks. The guidance will require institutions to:

1. Perform an analysis of the potential effect of a downturn in real estate markets on both earnings and capital;
2. Develop internal rating systems that consider an assessment of a borrower's creditworthiness and of an exposure's estimated loss severity to ensure that both the risk of the obligor and the transaction are clearly evaluated; and
3. "Measure and control CRE credit risk on a portfolio basis by … performing market analysis and stress testing."

These requirements will demand significant resources to produce and will be of little value to community banks. We note, again, that many institutions mitigate risk by lending in the less risky segments of the CRE market. In addition, the guidance fails to recognize perhaps the greatest risk mitigation tool available to community banks--the proximity of the lender to the borrower. These institutions, by their very nature, are closer to the economic realities of their markets and the credit worthiness of their borrowers. We must recognize that risk monitoring tools deemed valuable and reasonable for the larger institutions may not be feasible, valuable, or necessary for the smaller organizations.

The guidance also calls for banks to "compare the institution's underwriting standards for individual property types with those that exist in the secondary market." Institutions with standards which are "substantially more lenient" will be required to provide justification and document long-term plans for their credits. The secondary market plays a vital role for banks to mitigate risk and provide liquidity. However, we believe this homogeneous approach to commercial real estate credit limits lender judgment, diminishes the real value of a community banker, and will negatively impact the economic opportunities of small businesses and their communities.

We believe the proposed guidance will lead banks to determine they have little choice but to rethink the manner in which they serve their communities. Regulatory guidance should not chase banks from a business line where they understand the market and risks, to a business line in which they lack expertise. Diversion of bank resources into other lines could have significant negative effects on competition in even the lowest-risk segments of the CRE market and on the availability of CRE credit in local markets.

The current interagency guidelines for real estate lending (FDIC, Part 365) set an aggregate limit on CRE lending that exceeds supervisory loan-to-value ratios to no more than 30% of total capital. Institutions approaching this limit will receive "increased supervisory scrutiny." The guidelines outline the general supervisory review to include:

- The nature and scope of the institution's real estate lending activities.
- The size and financial condition of the institution.
- The quality of the institution's management and internal controls.

- The expertise and size of the lending and loan administration staff.
- Market conditions.

The current approach allows management flexibility and supervisory judgment based on actual conditions.

Supervisory tools are already available and actively used by regulators to deal effectively with unsafe practices and unsound concentrations in commercial real estate lending. State regulators report participating recently with federal regulators on joint examinations at institutions showing high CRE concentrations. In virtually all cases, either risk management practices were deemed sufficient or corrective action was implemented in a timely manner.

We note, as well, that pilot projects conducted by federal regulatory agencies to review observed CRE concentrations in several metro areas around the country disclosed that, by-and-large, institutions are utilizing appropriate risk mitigation techniques in CRE portfolios. These findings have been well publicized in FDIC publications.

It is appropriate to raise the awareness of risk in commercial real estate and to point out increasing levels of concentration. In doing so, however, we should not be overly or broadly prescriptive in how this risk is managed. We must also consider the shuttering effect such a regulatory pronouncement will have on bankers, small businesses and local economic development. We must have confidence in our supervisory processes and the enforcement powers already available and utilized by state and federal regulators.

Best regards,

Neil Milner
President & CEO

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