COMMUNITY BANK
OF NEVADA

April 7, 2006

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W. Washington, DC 20551
Attention: Ms. Jennifer J. Johnson, Secretary

Re: Docket No. OP – 1248/ Interagency Guidance on Commercial Real Estate Lending

Ms. Johnson:

The executive committee of Community Bank of Nevada has reviewed the proposed guidance by the federal banking regulators titled *Concentrations in Commercial Real Estate Lending (CRE), Sound Risk Management Practices* ("Guidance"*)*. We believe we subscribe to both the spirit and letter of many of the provisions contained in the proposed Guidance. Nonetheless, we have some concerns with the day-to-day operational practicality of the guidance, and believe that a number of recommendations in this guidance, both explicit and implicit, will increase inefficiencies, costs, and administrative burdens with only marginal returns to the safety and soundness of the nation's banking community.

The Committee on Banking, Housing and Urban Affairs, United States Senate (the Committee) held a very successful hearing on March 1, 2006 that focused on proposals for reducing regulatory burdens in the financial services industry. This demonstrated that there is an immediate need and broad support for moving forward on comprehensive regulatory relief legislation, as soon as possible. The burden of compliance with a host of laws, regulations, and supervisory guidance that do not provide meaningful protections for the public serves to add unnecessary cost to the delivery of financial services to the American Public. The proposed guidance is duplicative to other guidance that already exists throughout the supervisory system. It certainly conflicts with this proposed regulatory relief legislation, as it directs unnecessary burdens on the industry.

Community Bank of Nevada is a community banking institution with assets of nearly $1 billion. The make-up of our loan portfolio meets both of the real estate lending concentration tests in the guidance. We do agree that this type of lending requires responsible oversight by the board and management, and that strategic planning should address concentration levels relative to the institution's overall growth objectives, financial targets and capital levels. We also agree that close monitoring of the portfolio is important, and that consideration of many of the underwriting standards as outlined in the guidance are important tenets of real estate lending. However, overall we conclude that the guidance is overly-burdensome, unrealistic, and is neither cost-effective nor risk-justified relative to the requirements of the guidance.

We conclude that the requirement to collect, analyze, document and maintain the data required for review by the examination staff imposes significant new collections of information requirements. These guidelines operate in direct conflict with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR1320 Appendix A.1).

Below are some areas of particular comment.

Secondary Market

While we agree that the secondary market can be a useful outlet, underwriting specifically for such market is to ignore the composition, competition, and climate of local banking and business communities. We believe that generally community banks have sound real estate portfolios, and that they have been underwritten to standards that comport to the profitability, mission, and risk tolerance as established by their boards of directors. We do not believe that secondary market validation is the hallmark of a sound real

7676 W. LAKE MEAD BLVD. / LAS VEGAS, NV 89128
(702) 878-0700 / FAX (702) 869-5079

estate credit culture. It does not serve the industry to suggest that institutions with concentrations in CRE lending should generally perform this secondary market validation, as suggested. Again, for many community financial institutions, this requirement is overly burdensome, excessively expensive and not cost or risk justified. Therefore, we urge the Agencies to eliminate the requirement of underwriting to the standards of the secondary market as a means to demonstrate acceptable risk management.

Stress Testing

Currently we (and we believe most community banks in general) regularly document trends in national, regional, and local markets, and utilize such data responsibly, in updating lending guidelines, monitoring procedures, capital adequacy, and loss reserves. Additionally, like much of our competition today, we stress individual loans (via sensitivity analysis) as part of the initial underwriting process to make sure they can withstand a certain amount of interest rate shock. These standards vary with the type of project. CRE loans are diversified by geography, loan type, industry, location, tenant mix, and repayment source. Clearly, they do not present a single, concentrated risk. It would appear axiomatic that any system of analysis that aggregates such loans and classifies them as presenting a single type of risk is inherently flawed. Consequently, we do not believe aggregating these tests would provide meaningful information. Again, this requirement is also excessively burdensome and not cost or risk justified, nor would it be practical to expect community banks to routinely follow this portion of the guidance.

Currently, much of our portfolio is in construction and development versus permanent loans. It would be not only difficult, but it would not generally be meaningful to stress test construction loans. Their maturities are relatively short and are laddered throughout typical stress test periods. Again, the benefits in risk analysis provided by this exercise are not justified relative to the costs and burdens associated with this exercise for this portion of the portfolio.

Additionally, interest rate changes affect a broad spectrum of loans, including commercial and consumer, not just real estate. Indeed, changes in interest rates affect a financial institution's entire balance sheet. Bankers already assess the effects of interest rate swings at all decision-making levels, including asset/liability management and overall credit quality. The requirement to further granulate these analyses into sub-sets, such as one for CRE, is unnecessarily burdensome and not risk and cost justified for most community banks.

While we understand the thought process behind portfolio stress testing, we do not feel it is realistic, feasible for justifiable for most community banks. If portfolio-wide stress-testing is to be included in the guidance, we encourage the Agencies to provide additional, specific information as to how a bank could accomplish this, where it can obtain the appropriate information, and data about the source of the information and its accuracy. We believe that a bank that focuses on maintaining strong basic credit underwriting standards, a strong loan review program, good portfolio monitoring procedures, strong loan loss reserves, and a well-capitalized position is effective at managing risk. Focusing resources on creating reports and statistics that are not risk balanced and cost effective, will not offer additional value and will not increase effectiveness.

It must be noted that most assuredly, diminishing a bank's reliance on real estate lending does not automatically equate with diminished risk in the loan portfolio.

Capital Adequacy

While we perform, and we believe that most community banks perform, various tests to the real estate portfolio to assess capital adequacy, we disagree with the emphasis in this guidance statement that "institutions with CRE concentrations...should hold capital higher than regulatory minimums." If the agencies want to put out a "concentration" guidance and related capital guidance that is more directive than the guidance already provided to the industry by the regulatory agencies, then put out the guidance as is appropriate, under a "concentrations' guidance." Concentrations exist in a variety of forms. In the industry, there are many community banks highly concentrated in agricultural lending, or with concentrations in communities highly dependent on a particular industry or even a particular company. There are institutions highly concentrated by loan type, such as consumer credit card lending, or a particular lease product or second mortgage lending. This is where this capital and concentration guidance belongs. However, it is believed that the industry already has adequate capital and risk-based capital guidance.

We strive to—and do—operate above the "well capitalized" level. Additionally, we believe that a sound CRE portfolio is no more risky than unsecured or asset based business loans. Therefore, we encourage that decisions regarding capital adequacy in excess of regulatory requirements be made on a case-by-case basis, taking into account an institution's balance sheet; its risk management policies, procedures and performance; and the long-term performance of its portfolio. There should be no presumption that a concentrated real estate portfolio requires additional capital. Indeed, it is an incorrect premise to believe that loans secured by real estate constitute a greater risk of loss to banks than unsecured loans. Experienced bank professionals know that C&I loans, even when secured by receivables or inventory, rarely result in any meaningful recovery upon default.

It would be prejudicial to the competitive banking environment if community banks are required to hold higher levels of capital against their assets simply because such assets are primarily comprised of CRE loans.

Portfolio Stratification

We certainly agree, and support, that banks should be required to maintain a loan portfolio stratification analysis in order to track and pay attention to the possible development of any legitimate concentrations of credit risk. We currently stratify our portfolio on a number of levels, and continue to work on improving such analyses. However, the requirements promulgated in the guidance are excessively burdensome from both a capital- and labor-intensive standpoint for most community banks. Reports on strategic planning, contingency plans, feasibility studies, tenant analysis, tracking pre-sales, etc impose a mandate difficult for a community bank to meet. It is questionable whether such reporting will serve to increase the safety of the banking community. However, it most assuredly will serve to provide intense discussion points with field examiners.

Historically, business failures and unemployment are the primary reasons that real estate values decline significantly, not overbuilding, product saturation or high CRE portfolio concentrations. By the time of such declines, financial institutions with high concentrations in traditional Commercial and Industrial or Consumer lending should be far more concerned about portfolio losses when compared to institutions holding primarily commercial real estate.

It is also noted that the proposed guidelines do not apply to our competitors in the credit union industry. The burdens imposed by these guidelines only serve to further inhibit a level playing field in the financial services industry.

It is also noted in the proposed CRE Guidance that these obligations reinforce the Agencies' *existing* guidelines for real estate landing and safety and soundness. It makes reference to the Agencies' regulations on real estate lending standards and the *Interagency Guidelines for Real Estate Lending Polices:* 12 CFR part 208 (Regulation H), subpart E and appendix C (FRB). These already-existing guidelines establish approximately nine lending policy requirements, and another 55 – 60 Loan Portfolio Management requirements for consideration. Then, following this in the Regulation H appendix, are another six pages of narrative descriptions, guidance and explanations.

It does appear that in this new CRE Guidance there are requirements to review, consider and analyze another 60 to 70 items. The considerations, reviews and analyses of these items each take a considerable amount of time and effort and to give them thorough analysis and consideration, as well as some significant amount of data gathering and analysis. To perform these analyses adequately they frequently require information and studies from outside of the community bank itself. The examiners from the Agencies require that this information be maintained "current"; frequently suggesting that it be updated quarterly. Additionally, they request to review the banks' analyses for each of the matters identified. This requires that the institutions collect and analyze this information on an on-going basis and maintain the documentation supporting this in files for the examiners to review. These actions impose a considerable burden on our community banks.

<u>Summary</u>

The costs to perform all of these reporting and guidance requirements are significant and are passed through, almost always indirectly, to the consumers.

The proposed guidance imposes excessive regulatory burdens on the industry, especially as the supervisory agencies already have more than adequate guidance on concentrations in general, and on real estate lending concentrations. The substantial and significant requirements imposed by this guidance duplicate significant guidance that is already provided by the regulatory agencies and available to the industry, and therefore are not necessary. These guidelines not only operate in direct conflict with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR1320 Appendix A.1), but this proposed guidance also operates in direct conflict with the Senate Committee's proposed regulatory relief legislation.

In closing, we note the comments of former Chairman Greenspan at a speech in San Diego in March 2004, when, speaking of real estate, he stated that rather than constitute a dangerously risky trend among a few banks, "such credit exposures are a natural evolution of community banking."

Sincerely,

Don F. Bigger
Executive Vice-President
Credit Administrator

Cc: Mr. David Goode
Senior Manager
Federal Reserve Bank of San Francisco

Mr. Paul Ashworth
Supervisory Examiner
Nevada Financial Institutions Division