From: "Jack B. McKenney" <JMcKenney@alliancebankva.com> on 03/15/2006 10:10:06 AM

Subject: Interagency Concentrations in Commercial Real Estate Lending

Gentlemen:

These comments relate to the recent proposed guidance entitled "Concentrations in Commercial Real Estate Lending." The stated purpose of the proposed guidance is to focus financial institutions on whether they have a high concentration in commercial real estate and, if so, how they should adjust their risk management practices accordingly. The comments represent the views of the management of Alliance Bankshares Corporation, Chantilly, Virginia.

1. We agree that concentrations of all kinds, real estate and otherwise, should cause bank managers to adjust their risk management practices. The fact that an institution has the ability to capitalize on any market segment should not eliminate the need to apply good portfolio diversification theory and practice. We believe that most institutions recognize this fundamental of risk management and will make the adjustments necessary to protect depositors.

2. We believe the individual categories of lending included as "commercial real estate" in the proposed guidance represent significantly different levels of risk. In our opinion, loans for the purpose of acquiring and holding raw land potentially represent the highest level of risk a bank might encounter. Conversely, a residential construction loan on an average market price home to a reputable builder with a sales contract to a qualified buyer with a hard commitment from a mortgage lender for a permanent loan represents a very low level of risk. Yet the proposed guidance would seem to suggest that these two very different scenarios should be included in one bucket of risk. Similarly, an office, warehouse, or industrial property under construction with appropriate pre-leasing and/or permanent financing take-out from a reputable permanent lender is significantly different from a warehouse park land development loan. Again, the proposed guidelines do not appear to give banks and their regulatory bodies room to distinguish between these levels of risk.

   Similar distinctions can be made for income producing properties that would be subject to the 300% risk bucket. Special or single purpose properties, hotels/motels, timeshares, and other commercial properties represent far different levels of risk than an anchored strip center, a multi-tenanted office building or an apartment building.

3. We believe that the existing Board "Commercial Bank Examination Manual" already provides regulators with sufficient guidelines to address any concerns the regulatory body might have in dealing with an individual institution and their real estate exposure. Specifically, in Section 2090.4, regulators are instructed to do the following:
   a. Determine that the bank's board and management have established policies regarding:
      i. Target market
      ii. Diversification standards
      iii. Prudent, clear and measurable underwriting standards
      iv. Appropriate procedures for origination and approval
      v. Loan review and documentation standards
      vi. LTV limits that are consistent with regulatory limits
      vii. Regular reporting to the board of directors.
   b. Determine whether the policies and objectives are <u>appropriate to the size and sophistication of the bank, and whether they are compatible with changing market conditions.</u>

Section 2090.2 also directs regulators to review a bank's real estate lending policies, procedures and practices <u>to ensure that these functions are adequate to identify and manage the risks to which the particular bank is exposed</u>. Further, regulators are charged to initiate corrective action when those safeguards are deemed to be deficient.

Thus, in our opinion, the establishment of the 100% and 300% risk buckets may in fact undermine regulatory efforts by giving institutions the ability to argue that they are under the guidelines when the actual risks in their portfolios may be substantially greater, though within the proscribed limits. <u>We would submit that a portfolio that is 90% of capital in raw land is substantially riskier than one containing 150% of capital in single family construction loans backed by sales contracts.</u>

4. In the event that the Board determines to proceed with establishment of the 100/300 rule, we respectfully request that it err on the side of over-documenting how on-site regulators will interpret the guidelines and painstakingly define what adjustments in risk management practices are expected. The Board should make every effort to ensure that what is expected of any particular institution is consistent across regulatory teams and that there is adequate time for the examined institution to implement the as yet undefined requirements before adverse consequences attach.

5. In summary, we believe that regulators already have the ability to accomplish the letter and spirit of the proposed guidelines without additional action on the part of the Board. Establishing these new guidelines adds little to regulatory oversight but does potentially increase the probability of bankers taking increased risk by avoiding appropriate collateral structures, missing sound lending opportunities, or venturing into new lending areas where they lack the experience, procedures, policies and process to lend safely just to avoid exceeding the 100/300 limits.

Respectfully submitted:

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Alliance Bank