March 15, 2006 564

Robert E. Feldman
Executive Secretary
Attention: Comments
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Comments@FDIC.gov

Regulation Comments
Chief Counsel's Office
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1700 G Street, N.W.
Washington, D. C. 20552
Attention: No. 2005-56
regs.comments@ots.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20th Street & Constitution Avenue, N.W.
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Office of the Comptroller
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Re: **FDIC** (No docket ID); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21; **OTS** Docket No. 2006-01; **Proposed Interagency Guidance on Concentrations in Commercial Real Estate**; 71 Federal Register 2302; January 13, 2006

Ladies and Gentlemen:

I am writing on behalf of the Virginia Bankers Association (the "VBA") to comment on the above proposal. The VBA represents the interests of nearly all of the commercial banks and savings institutions doing business in the Commonwealth of Virginia.

In March of 2004, former Federal Reserve Chairman Alan Greenspan noted in a speech in San Diego that the growth in commercial real estate lending by smaller banks was a "natural evolution of community banking and ... quite profitable, helping to sustain both earnings and growing equity capital of community banks." He went on to state that "the evidence suggests that community banks have avoided the underwriting mistakes that led to so many problems ten to fifteen years ago."

The former Chairman's remarks underscore the importance of commercial real estate lending to community banks. Our community banks rely heavily on commercial real estate lending to survive and make a profit. They do so because they have been squeezed out of so many other areas where they once did a significant business. For example, the car manufacturers now have captive finance companies that dominate car lending. Realtors now take advantage of their position as the first contact in the home-buying process to arrange mortgage financing for buyers through their mortgage

rather than "commercial" reasons. In addition, we believe that the 100% capital threshold is much too low. It should be raised to 200% to the extent there is any threshold at all. Also, we believe that commercial real estate loans with a loan-to-value ratio of 65% or less should not be counted toward the thresholds, as the risk of loss on such loans is minimal or non-existent.

2. The proposed guidance fails to recognize that commercial loans secured by real estate present less of a risk than loans not secured by real estate.

One of the underlying premises of the proposed guidance is that commercial real estate loans pose greater risks than other loans. We disagree with this premise.

Would a bank be in a safer position with an unsecured line of credit as opposed to a line of credit secured by real estate? Of course not, but that is how the proposed guidance treats the two loans.

Indeed, we believe that commercial loans secured by real estate pose less of a risk of loss than commercial loans secured by other sources of collateral, such as receivables, inventory, or equipment. Covering losses by foreclosing on other forms of collateral is subject to all kinds of perils, such as bad behavior on the part of the borrower. Real estate, on the other hand, is a very reliable source of collateral.

Furthermore, even if the value of real estate securing a commercial loan falls, it would have to fall significantly before the bank loses any principal. This is because most such loans are made with a loan-to-value ratio of 75% or less. Add to that the fact that a borrower will likely have paid some principal before defaulting, and you can see that the real estate would have to drop roughly 30% before the first dollar of loan principal is put at risk. For this reason, far from representing a "concentration" risk, commercial real estate loans are some of the safest loans on our community banks' books and thus should not be targeted for the kind of burdensome new requirements that have been proposed.

Quite simply, a community bank that is forced to hold a much higher level of capital against its assets than a larger competitor bank will be forced to price much higher than its competitor or accept a lower return on shareholder equity. Neither approach would lead to growth, which is why, again, an increased capital requirement threatens the very survival of many community banks.

5. The proposed guidance adopts a "one-size-fits-all" approach when <u>any concerns would be better addressed on an individual bank basis.</u>

We believe the proposed guidance would unfairly punish all community banks for the problems (now or in the future) of a relative few. We urge the federal banking agencies to reconsider the approach of the proposed guidance.

In particular, we believe the agencies, and more importantly, community banking, would be much better served if the agencies applied existing guidance to problem banks rather than subjecting all banks (the vast majority of which pose no problem at all) to complicated and burdensome new requirements. In particular, we believe that fears associated with isolated geographic areas or a handful of banks are no justification for strangling an entire industry with new regulatory burdens. In short, the agencies can use existing law and their supervisory and examination authority to require those banks that pose unique risks to take the appropriate steps to address those risks. It is simply unnecessary to harm all banks in attempting to cure a few.

* * *

In conclusion, we emphasize that the proposed guidance would primarily impact our community banks. It will surely make it more difficult for our community banks to compete in the safest and most profitable business left for them. If the federal banking agencies care about the survival of community banking, they should not adopt this proposal.

Thank you for considering our views.

Sincerely,

Walter C. Ayers
President and CEO

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