MID PENN BANK

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April 11, 2006

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

RE: Proposed Interagency Guidance on Concentrations in Commercial Real Estate Vol. 71, No. 9, Federal Register 2302, January 13, 2006

Dear Mr. Feldman:

I am writing to comment on and express my serious concerns about the proposed CRE Guidance. To give you some perspective on my reaction to the proposal, this is the first time in over 10 years that I have provided comments to proposed regulations, which should give you some indication of my level of concern.

General Summary

The proposed guidance will significantly impact our ability to competitively originate CRE loans in that we would have to maintain significantly higher levels of capital and higher loan reserves. We would incur substantial increases in administrative costs to adhere to the risk management requirements described in the guidance. All of these additional costs place us at a competitive disadvantage compared to larger banks, credit unions, and other providers of CRE lending and will most definitely impact the profitability of our Bank.

Our calculations indicate that we would be at a concentration of 103.5% for construction land development loans and 517% of capital for other CRE loans per the definitions in the proposal. We see these levels growing over time since other types of lending are not readily available to us in our market.

We are an institution with approximately $440 million in assets and significantly contribute to the economy in our area by originating CRE loans. CRE loans are our bread and butter, and we see the proposed regulations curtailing our ability to originate loans to businesses that create jobs in our service area. The regulations will create greater costs for us and will put us at a competitive disadvantage to the other competitors mentioned above.

The current regulatory burden is a huge weight for community banks our size. Regulation after regulation keeps adding to the collective burden. This guidance would add additional costs to administer and create an administrative burden. If all aspects of the guidance are implemented, a full-time position would need to be added to our staff to deal with the guidance recommendations. Further, the cost of acquiring software and building information systems to meet the guidelines would be significant. The costs of staffing and systems to comply could easily add $100,000 in costs, with the majority of these costs continuing in future years.

The guidelines appear to ignore differences in banks' competing markets. Our loan portfolio has grown by 8 to 10% per year over many years. Our market has never experienced explosive growth, and in fact, has had stable growth for many years avoiding the boom and bust of other markets. The guidance is a "one size fits all" approach. Certainly, there are markets that have had explosive growth, and banks originating CRE loans in these markets have higher risk exposure. Don't burden the entire banking system with guidance, but address those institutions that are doing the wrong things through existing regulations and pose the most risk to the FDIC.

Definitions

The guidance lacks adequate definitions for key areas starting with the definition of CRE loans. It appears that certain residential construction loans financed directly to consumers are included in the Type 1, 100% category. The guidance appears to include owner-occupied commercial real estate loans in Type 1 CRE loans. The guidance does not define an owner-occupied CRE loan, particularly the percentage of space occupied by the owner, that would qualify it as "owner-occupied."

The guidance does not define or address additional capital levels or additional loan reserves that would be required by institutions with high CRE concentrations. These are critical areas and must be clearly defined.

Heightened Risk Management Practices

In general, the heightened risk practices described in the guidance are substantial, and I am certain few banks have all of the practices in place, not even the largest banks.

Our Management Information Systems (MIS) do not presently have the capability to allow us to comply with the practices described in the guidance. Building these systems, while possible, will take considerable resources. Many of the practices at present would have to be performed on a manual basis. Our MIS do not have the data in place or possibly will not be able to be expanded to include information to manage the portfolio in compliance with the guidelines. The level of detail described in the guidance simply is not available in our current MIS, and the implementation of this level of detail is simply overwhelming.

The amount of information proposed by the guidance is substantial. Reports on market conditions, vacancy rates, occupancy levels, residential rental vacancies, etc. are either simply not available or limited in our market.

Most community banks do not have systems in place to stress test the portfolio in compliance with the guidelines. Certainly, our MIS do not allow us to perform these tests, which means we would have to purchase new software to conduct stress testing or do so on a manual basis with limited market data, limited ability to extract portfolio data by stress testing criteria, and lacking software to perform stress testing. I see our ability to comply with this area of the guidance as questionable in the short run. Over time, we could develop these systems, but the burden and resources required will be substantial.

Higher Levels of Reserves

Recognizing that our CRE portfolio has greater risk than a diversified residential mortgage portfolio, we have maintained a higher level of reserves. Our level of reserves is reviewed in every examination and has been found to be adequate considering the composition of our portfolio. The guidance appears to indicate that banks such as ours that exceed the 300% concentration level will need even greater reserves. These levels of higher reserves are not defined in the guidance and would potentially have a profound impact on our institution.

We have had CRE concentrations in excess of the 300% level for many years and have managed our portfolio in recognition of the risks our portfolio presents. Our losses from CRE loans have been consistent with or lower than peer group banks in the Uniform Bank Performance Reports we utilize as a means of comparison. In spite of a proven track record for managing a more heavily concentrated CRE portfolio, it appears that we will be penalized by the guidance and most likely will have to increase our Loan Loss Reserve.

Conclusion

If the guidance is enacted as proposed, the impact on Mid Penn Bank will be extensive, burdensome, and will result in curtailed CRE lending. The guidance will likely require greater capital, increased Loan Loss Reserves, and substantial resources to comply with the heightened risk management practices we will be required to implement.

Our alternatives to CRE lending pose equal or greater risks. Asset-based lending or unsecured business loans are two examples of alternatives that would create even higher risks in our institution. Does it make sense to push us into this type of lending to avoid CRE loans?

While additional regulation has moved at a fast and furious pace, this one seems to top them all as far as impacting Mid Penn Bank. CRE lending is one of the few markets we can compete in and is the most profitable business line in our institution. The guidelines clearly will curtail our lending in our most profitable line of business. We have effectively managed risk in our portfolio under present regulatory requirements, why saddle us with substantial additional requirements?

If enacted, this guidance will have a severe impact on our Bank's ability to grow, our profits, and our ability to serve our communities. This is just poor regulation.

Sincerely,

Alan Dakey

Alan W. Dakey
President and CEO

AWD/clw