CHICOPEE SAVINGS

WILLIAM J. WAGNER
PRESIDENT

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By

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April 11, 2006

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th State 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 20551
Attention: Docket No. 2006-01

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Streets, 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

RE: Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices

Dear Sir or Madam:

We would like to express our concern with the proposed federal guidance on commercial real estate ("CRE") lending and the impact it will have on community banks and the community they serve. We appreciate that state and federal 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 the local community. Furthermore, we recognize the risks that concentrations in commercial real estate can pose and the importance of banks exercising strong risk management monitoring tools. After reviewing the proposed federal guidance, we have several concerns regarding the proposal:

- 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.

We actively monitor the bank's portfolio and concentration in commercial real estate lending. The results are reported to the Board of Investment on a quarterly basis.

Based on the calculation on the previous page, Chicopee Savings Bank does not have a concentration in CRE loans in either category that exceed the guidance threshold which would require heightened risk management practices. Total reported loans for construction, land development and other land is calculated at 38% well under the 100% threshold. Total reported loans secured by multi-family and non-farm non-residential properties and loans for construction, land development and other land represents 146% and under the 300% threshold.

We are also concerned that the federal guidance does not place any weight on a seasoned portfolio with loans carrying a loan-to-value ratio below regulatory requirements. It also does not differentiate the diversity within the portfolio in regards to the borrower/developer concentrations (Chicopee Savings Bank's Lending Policy states that borrowers will be limited to two (2) speculative construction loans at any one time), the geographic location, property type and industry. Again, there are multitudes of sub-markets within the CRE category that are categorized by varying levels of risk.

There is also an issue with carving out owner-occupied property from the threshold limit. The problem is that regulators do not know how much CRE is owner-occupied since this information is not collected in the quarterly call report. Although management internally monitors the diversification based on owner and non-owner occupied CRE, it is reported on the call report as one total.

We are not in disagreement with the risk management principals outlined in the guidance. It is in everyone's best interest to be knowledgeable of the risk in any line of business and concentrations in general. However, risk-monitoring processes utilized successfully by the largest institutions are less valuable by the smaller institutions. In addition, the guidance fails to recognize the greatest risk mitigation tool available to the community banks – the proximity of the lender to the borrower. These institutions by

their very nature are closer to the economic realities of their market 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 community banks.

It is appropriate to raise the awareness of risk in commercial real estate but that it is vital that we continue to have confidence in our supervisory processes and the enforcement powers already available and utilized by state and federal regulators. The fact is that banks are heavily regulated through reporting, off-site monitoring and regular on-site examinations.

Ultimately, we are concerned with the unnecessary burden several of the requirements in the guidance will place on Chicopee Savings Bank. Although we are well under the threshold limits, the guidance will require that we:

- Perform an analysis of the potential effect of a down turn in real estate markets on both earnings and capital;
- 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
- "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 Chicopee Savings Bank due to the threshold calculations being well under the federal guidance 100/300 thresholds. It should also be noted that many institutions mitigate risk by lending in the less risky segments of the CRE market. 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 in joint examinations at institution showing high CRE concentrations. In virtually all cases, either risk management practices were deemed sufficient or corrective action was implemented in a timely manner.

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.
In a RMA article dated September 2004 by Kathleen M. Beans, it was noted that John Lane, deputy director of supervision and consumer protection at the FDIC, discussed several regulatory concerns. Mr. Lane commented on the concentrations in commercial real estate portfolios. He noted that the FDIC was "pleasantly surprised" when it reviewed institutions with the greatest concentrations and investigated the numbers on the Call Report. "Over 50% of the commercial real estate loans were to owner-occupied businesses," he said. "These loans had more than just a single source of repayment based on the collateral value of the underlying real estate. They also had the income of

the business. We get some additional comfort in knowing that there's a source of repayment other than the property," he said. "We were also pleasantly surprised by the very sound underwriting that was present in loans where the owner of the property had invested a good amount of equity. The underwriting was solid and repayment was not an issue." The article also stated that the "OCC's experience with commercial real estate portfolios is similar to the FDIC's findings. The OCC, which examined commercial real estate concentrations during a horizontal review of its mid-size banks ($5-25 billion) and community banks, found the real estate portfolios to be largely sound"

As mentioned above, it is appropriate to raise awareness of risk in commercial real estate and to point our increasing levels of concentration. However, we should not be overly or broadly perspective in how this risk is managed. We must also consider the shuttering effect such regulatory pronouncement will have on bankers, small businesses and the local economic development. The federal guidance may force community banks to reduce their commercial real estate lending and force the community to be serviced by the larger Banks..

In closing, the current approach allows management and the Board flexibility and supervisory judgment based on actual conditions. We ask that as a regulatory body you reconsider the proposed federal guidance due to the impact it will have on community banks and the local economic development and restore confidence in the supervisory processes and the enforcement powers already available and utilized by state and federal regulators.

Sincerely,

William J. Wagner

William J. Wagner
President & CEO

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