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SUBMITTED BY INTERNET TRANSMISSION

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

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street , NW
Washington, DC
Docket No. 2005-56

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve
20th Street and Constitution Avenue
Washington, D.C. 20551
Docket OP-1248

Office of the Comptroller of the Currency
250 E. Street SW Mail Stop 1-5
Washington, DC 20219
Docket 06-01

Re: Interagency Guidance on Concentrations in Commercial Real Estate Lending

Ladies and Gentlemen:

I am writing to provide comments to the proposed Interagency Guidance on Concentrations in Commercial Real Estate Lending. I am an attorney with 30 years of experience in representing community banks, primarily in New York State. I concur with most of the comment letters already submitted which provide comprehensive analyses of the specific weaknesses of the proposed guidance, and I will not burden you with a reiteration. Instead, I would like to take this opportunity to present a more global assessment of the ultimate practical effect of the proposed guidance on community banks.

In the past 30 years, we have seen many upheavals in the banking and real estate markets, including the interest rate escalation of the late 1970s and early 1980s that caused a collapse in spread and the real estate market turmoil of the late 1980s that was one of the principal causes of the savings and loan failures. In response to those problems, statutes and regulations have been enacted to protect the strength of the banking industry. These include, among others, federal pre-emption of state usury ceilings, mandatory appraisal requirements, prudential lending requirements, formalization of procedures for the analysis of the allowance for loan losses, proper accounting for acquisition/development/construction loans and mandatory board review of interest rate sensitivity analysis.

In addition, and crucial to this issue, we must not forget the effect of the 1986 Tax Reform Act on the upheaval in real estate values, especially non-owner occupied commercial

real estate, that occurred in the late 1980s and early 1990s. Prior to 1986, passive commercial real estate investments had the benefit of substantial tax write offs. The passage of the 1986 law eliminated those benefits. This caused a dramatic decline in non-owner occupied commercial real estate values beginning in 1987, because investors were no longer able to obtain the same tax benefits. However, with passive real estate tax shelter investments having been consigned to the history books, we do not face the same risk of collapse in value that was one precursor to the savings and loan debacle. Non-occupant investors now buy properties, and banks value them for loan purposes, based upon intrinsic value derived from rental income, not based upon phantom value stemming from tax strategies. Therefore, the fact that commercial real estate is not occupied by the owner should not create the taint that it once did.

The laws and regulations adopted in the aftermath of the savings and loan debacle, as now implemented by the banking industry, provide comprehensive protections against many of the asset quality and asset risk problems the industry has faced in the past. Some loan defaults are inevitable. However, in many communities, particularly in the New York City metropolitan area, commercial real estate that is not owner occupied is the order of the day. A one size fits all response to a perceived problem is misguided. Examiners should not be given the license to criticize a bank's CRA performance because its loan to deposit ratio is too low when the institution is under pressure to reduce commercial mortgage loans, especially when those are the most common, and often safest, loans available to it. What choices does the institution have? Make unsecured C&I loans? An even riskier loan category. Make only mortgage loans to owner occupants? Not a viable choice in an area, such as New York, where the percentage of non-owner occupied commercial real estate is so high. Make interest-only residential mortgage loans with payment shock risk? Need I say more?

For community banks, commercial mortgage loans are essential to their survival. Imposing extra limitations on their ability to make those loans – such as requiring a larger capital base or burdensome analyses of sensitivity - represents a back door attempt to impose the Basel II framework on community banks in the United States. Community banks do not make loans to publicly traded companies with rated debt securities. They make loans to small businesses and small real estate owners who form the backbone of the American economy. To suggest that these loans create an undue risk profile is simply a misplaced analysis. By what logical process can one argue that a mortgage loan to a pizza parlor that owns its own building is a lower risk loan that a loan to an investor who buys the building and rents it to the pizza parlor at a rent sufficient to repay the loan? In the first case, there is only one source of cash flow – the income from the pizza parlor. In the second case, there is the income from the pizza parlor and the economic strength of the investor.

In the aftermath of the savings and loan collapse and the adoption of FIRREA, all we heard from examiners was, "What's the secondary source of repayment? And what's the tertiary

source?" The failure to have three sources of repayment was often cited as an unsafe and unsound practice in the late 1980s and early 1990s. How does an institution avoid that criticism when it is not allowed to diversify its real estate lending risk by seeking multiple sources of repayment? Two sources of repayment, or three, are always better than one. An argument, albeit a weak one, could be made in favor of imposing additional monitoring obligations for non-recourse non-owner occupied commercial real estate when there is no personal liability of a financially viable person, but no such obligation should be imposed when the borrower or guarantors are financially strong beyond the value of the mortgaged real estate.

I must also comment on the regulatory realities of the adoption of regulatory guidance. In the day to day trenches of actual bank operations, examiners rapidly convert guidance into criticisms, guidelines become absolute limits, and criticisms rapidly morph into "Apparent Violations of Law" on Reports of Examination. If the bank regulators are concerned about commercial real estate loans, then they should be just as concerned about C&I loans, unsecured credit card loans, and the many other categories of loans that will cause problems if the economy, through no fault of the bank, has a hiccup. Drawing a line at 100% of capital, or 300% of capital, simply puts community banks at a serious competitive disadvantage. The loans they could otherwise make or participate in will instead have to be given up to large banks that can diversify by making loans to foreign governments and companies traded on the New York Stock Exchange, insurance companies with much lighter regulation of asset quality, pension plans with virtually no regulation of asset quality, and other non-bank lenders. The community banks will be forced to accept either the lower rates of interest available in the bond markets or the higher risks of C&I loans, credit cards and home equity lending.

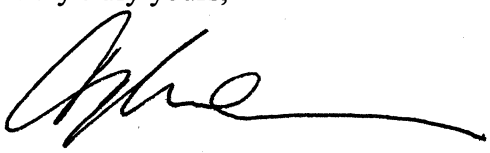
The inevitable result of all of this will be more earnings pressure. We are already seeing banks decide to merge out of existence because administrative and compliance costs are too high. Monopolization is a bad thing. We already have two banks in the United States that control more than 5% of the deposit market. Although that is far from the European model, it is getting closer. Imposing unnecessary restrictions will only result in additional consolidation. The risk to the insurance fund from one large bank failure far outweighs the risks cause by community banks making commercial mortgage loans on non-owner occupied properties. Furthermore, creating a disincentive to residential multi-family housing financing, especially in areas like New York where apartment living is so important, is simply bad public policy.

Requiring another layer of administrative review of loan transactions, thereby forcing banks to shed loans that would otherwise provide material contributions to interest income and replace them with lower yielding investment securities, will only create more earnings pressure. There is a very fine balance in the CAMELS analysis between capital, assets and earnings. The proposed guidance will push all three of these in the wrong direction by increasing capital

requirements, forcing institutions to shed good earning assets, and imposing additional non-productive administrative expenses.

We do not want a situation, as is the case in many European countries, where there are a handful of large banks, a small basket of medium sized banks, and no other meaningful competition. It's time for the regulatory authorities to recognize the increasing burdens they impose on community banks on a daily basis and take a step back from the brink. A good start would be a withdrawal of any percentage guidelines and the replacement of the proposed guidance with a simple statement that banks are expected to implement reasonably appropriate procedures, taking into account their size, the nature of the local market, and the particularities of their loan portfolios, to monitor the effect of external risk factors on their financial condition and results of operations.

Very truly yours,



Jay L. Hack