NATIONAL ASSOCIATION OF HOME BUILDERS

REGULATORY & HOUSING POLICY

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Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Attn: Docket No. OCC-2008-0006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comment/Legal ESS

Ms. Jennifer J. Johnson
Secretary, Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
Attention: Docket No. R-1318

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn: OTS-2008-0002

Subject: Joint Notice of Proposed Rulemaking - Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework

Dear Sirs and Mesdames:

On behalf of the 235,000 members of the National Association of Home Builders (NAHB), I welcome the opportunity to respond to the Notice of Proposed Rulemaking (NPR), on the Basel II Standardized Capital Adequacy Framework (Standardized Framework or the Proposal) issued jointly by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS), collectively, the Agencies. This NPR sets forth the Agencies' proposed domestic application of the Basel II Standardized Framework, while considering the unique features of the U.S. market.

NAHB is a national trade association representing individuals and companies involved in the production of housing and related activities. Each year, NAHB's builder members construct about 80 percent of all new housing in America. NAHB's builder members are predominately small businesses with limited capital of their own. These small businesses depend almost entirely upon commercial banks and thrifts for credit. The capital treatment of these types of loans, therefore, impacts the cost and availability of housing production credit and is critical to the performance and health of the home building industry. Likewise, regulated depository institutions play a major role in financing home purchases and rental housing properties, so the impact of the proposed revisions on the capital requirements for single family and multifamily mortgages also have an important bearing on the affordability and availability of homeownership and rental housing opportunities.

Background

The current U.S. risk-based capital rules were adopted in 1989 and are based on the Basel Capital Accord, an internationally agreed upon framework for measuring and determining the capital requirements for financial institutions (Basel I). Since the implementation of the Basel I framework, the Agencies have made numerous revisions to their risk-based capital rules in response to changes in financial market practices and accounting standards. In more recent years, the Agencies and international regulators have been working together to develop a new version of the Basel Capital Accord known as the New Accord or Basel II, which was adopted by the Basel Committee on Banking Supervision in June 2006. The intent of the New Accord is to better align minimum capital requirements with enhanced risk-measurement techniques and to encourage banks to develop a more disciplined approach to risk management. Basel II includes a standardized approach, which is the focus of this comment, and an advanced approach, which is required for the largest and most internationally active domestic financial institutions (accounting for about 50 percent of U.S banking assets). This is the most complex risk-based capital approach and requires sophisticated modeling tools to calculate risk weightings by each asset category and segment. A final rule was issued on December 7, 2007 implementing the advanced approach.

On December 26, 2006, the agencies issued an NPR (Basel IA) that proposed modifications to Basel I with the objective of enhancing the sensitivity of risk-based capital rules for those institutions who would not be adopting the advanced approach. Many commenters, representing a broad range of U.S. banking organizations and trade associations, urged the Agencies to implement the New Accord’s standardized approach for credit risk in place of Basel IA. Generally, the comments stated that the standardized Basel II approach is more risk sensitive than the Basel IA proposal and would more appropriately address the industry’s concerns regarding domestic and international competitiveness. The Agencies agreed and the Basel IA proposal was eliminated in favor of the Standardized Framework. Institutions not required to adopt the advanced approach will have the option of employing the Standardized Framework or continuing to use the current set of U.S. Basel regulations (Basel I). This Proposal is generally consistent with the standardized approach outlined in the New Accord, but diverges from that Accord to incorporate more risk sensitive treatment, most notably for mortgage-related assets that have characteristics unique to the U.S. system of mortgage finance.

NAHB Position

NAHB continues to endorse attempts by the Agencies to refine bank capital requirements so that an institution’s capital level is a more precise and direct reflection of its risk profile.

NAHB is pleased that the Agencies have retained the capital treatment of residential acquisition, development and construction (AD&C) loans and residential mortgages proposed in the prior notice on Basel IA. As we stated in our comment letter dated March 26, 2007, NAHB strongly supports the Agencies Proposal to retain the current statutory risk weightings for pre-sold one-to-four family construction loans and certain multifamily loans. Further, we support the expansion of risk weights for residential mortgages based on loan-to-value ratios. However, as discussed in the balance of this letter, we have concerns with some of the proposals in these areas and we urge the Agencies to consider some modifications.

Residential Acquisition, Development and Construction (AD&C) Loans

Under the proposed Standardized Framework, and pursuant to the Resolution Trust Corporation Refinance, Restructuring and Improvement Act of 1991 (RTC Act), construction loans on pre-sold single family homes and certain multifamily loans meeting statutory requirements are assigned a 50 percent risk weight. All other residential AD&C loans, including pre-sold single family construction loans where the purchase contract is cancelled, are assigned a risk weight of 100 percent. NAHB believes that the decision to retain the current regulatory capital treatment for RTC Act loans is reflective of the Agencies' recognition of both the important risk mitigating techniques in AD&C lending and the strong credit characteristics of multifamily loans that meet specific statutory and other underwriting criteria.

Further, this is consistent with the findings in a June 2003 Board white paper entitled, *Loss Characteristics of Commercial Real Estate Loan Portfolios*. The white paper found that key features of single family construction loans, such as a high proportion of pre-sales and substantial borrower equity, are positive factors contributing to lower capital requirements for such loans.

However, we urge the Agencies to make additional distinctions among the different forms of real estate loans in the 100 percent risk weight category. We believe that additional exclusions from the 100 percent category should be considered for loans which have significant equity and/or pre-sale arrangements. Risk mitigation techniques such as these can provide additional lender security and lower risk of default. Loans that would potentially fall into such categories would be land development loans where the developer has contributed substantial equity and loans to finance construction of sub-divisions which have a significant percentage of pre-sold homes.

In addition, NAHB is concerned that the Standardized Proposal adds capital charges for AD&C lending that could potentially have an adverse impact on a builder's ability to attain financing from a banking organization at a reasonable cost. Under the Proposal, additional risk weights will be added to unfunded commitments related to homebuilders' AD&C projects not immediately cancelable. This requirement is new and is not required in the existing General Basel (Basel I) regulations for most banks. Unfunded commitments must be multiplied by Credit Risk Conversion Factors (CCFs) to obtain risk weights as follows: (1) zero percent for unconditionally cancelable commitments; (2) 20% for commitments with an original maturity of one year or less that are not unconditionally cancelable; and (3) 50% for commitments with an original maturity of more than one year that are not unconditionally cancelable by the bank.

NAHB is concerned that these additional capital charges will raise costs, especially for builders relying on smaller community banks. Builder/developer loans are used to purchase land; develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. Loans extended to builder/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a 6-to-18 month period. The principal and interest on the loans is repaid to the lender when homes are ultimately sold. Thus a bank's unfunded obligation to a builder on an ongoing residential construction project could be significant.

Under the Standardized Proposal, these banks must allocate scarce capital on residential construction projects that they heretofore were not required to hold. Shareholder demands and earnings and regulatory pressures could result in higher required returns on capital allocated to unfunded commitments. This could directly result in higher fees and/or costs to builders, even on well-underwritten and performing projects.

Also in relation to AD&C lending, it is common for banks to secure personal guarantees from builders (either a direct guaranty from the builder or from other individuals). Banks underwrite these loans in consideration of these guarantees. Importantly, the Proposal would allow a bank to recognize the risk mitigation benefits of an eligible guarantee by substituting the risk weight associated with the eligible guarantee for the risk weight assigned to the underlying exposure. This substitution is consistent with that used in Basel I, but would allow for a much broader range of guarantors and a broader range of risk weights based on the external ratings of the guarantors.

Unfortunately, under the eligibility requirements of Section K (Credit Risk Mitigants) of the NPR, personal guarantees are not eligible for risk mitigation purposes. NAHB recommends that personal guarantees, that are in writing, non-cancelable by and legally enforceable against the protection provider, and deemed as an adequate risk mitigant by the bank, be considered an eligible guaranty under the Standardized Framework. In many cases this will reduce overall construction costs for a builder and keep economically rational projects funded rather than threatened with foreclosure to the detriment of borrower and bank.

Residential Single Family Mortgages

As noted, NAHB endorses the Agencies' attempts to more closely align bank regulatory capital requirements with an institution's overall risk profile. The Agencies existing risk-based capital rules (Basel I) assign first-lien, one-to-four family residential mortgages to either the 50 percent or 100 percent risk weight category, with most one-to-four family mortgages receiving a 50 percent risk weighting. To be eligible for the 50 percent category, a first-lien mortgage must be owner-occupied or rented, prudently underwritten, not past due more than 90 days and performing in accordance with its original terms. Stand alone junior-lien residential mortgages are assigned a 100 percent risk weight.

The Agencies are proposing to risk weight first-lien single-family mortgages based on loan-to-value (LTV) ratios, with the intent of increasing the risk sensitivity of the Basel I risk-based rules while minimizing the increase in regulatory burden for banking institutions. The Proposed Standardized Framework generally is consistent with the standardized approach outlined in the New Accord, but diverges from the New Accord to incorporate more risk sensitive treatment, most notably for residential mortgages held by U.S. banks. The Agencies propose to assign prudently underwritten, owner-occupied or rented, first-lien, one-to-four family residential mortgages that are not 90 days or more past due or on nonaccrual to risk-weight categories based on the LTV ratios as described in the following table:

Risk Weights for First-Lien Residential Mortgages[1]

LTV Ratio (%)	Risk Weight (%)
60 or less	20
Greater than 60 and less than or equal to 80	35
Greater than 80 and less than or equal to 85	50
Greater than 85 and less than or equal to 90	75
Greater than 90 and less than or equal to 95	100
Greater than 95	150

LTV ratios will be calculated after consideration of any loan-level private mortgage insurance covering a specific loan if the issuer is not affiliated with the banking organization and meets specific ratings standards. Also, like AD&C risk weighting requirements, the Standardized Framework provides that a bank would hold capital for both the funded and unfunded portions of residential mortgage exposures (negative amortization features or a home equity line of credit would create unfunded residential exposure). A bank would risk weight the notional amount of the unfunded exposure, that is the maximum contractual commitment, multiplied by the appropriate CCF. In addition, a first-lien residential mortgage exposure that has been restructured could not receive a risk weight lower than 100 percent unless the bank updates the LTV ratio at the time of restructuring.

The Agencies also propose that stand alone junior-lien residential mortgage exposures should be risk weighted with the intent of increasing risk sensitivity. The regulated entity would assign a risk weight to the amount of the junior-lien residential mortgage exposure in accordance with the table below. A junior-lien that is 90 days or more past due or on non accrual status would be risk weighted at 150 percent.

Risk Weights for Junior-Lien Residential Mortgages

LTV Ratio (%)	Risk Weight (%)
Less than or equal to 60	75
Greater than 60 and less than or equal to 90	100
Greater than 90	150

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[1] Note: The definition of a first-lien mortgage exposure includes a residential mortgage exposure secured by first and junior-liens where no other party holds an intervening lien.

NAHB believes the Agencies approach to risk weighting residential mortgages is reasonable and that utilizing LTV ratios as the basis for risk weighting one-to-four family mortgages achieves an effective balance that introduces additional risk sensitivity in the capital rules for home mortgage while minimizing burdensome and costly compliance. Through the supervisory process and in accordance with the NPR, the Agencies would continue to assess a banking organization's underwriting and risk management practices consistent with supervisory guidance and safety and soundness, and would require a banking organization to hold capital in excess of the requirements where appropriate. NAHB supports the Agencies' intent to use the examination process to assess the need for supplemental capital for single family mortgages with more risky or nontraditional features. This case-by-case approach is the appropriate method for addressing the higher degree of credit risk that may be associated with such loan structures.

Multifamily Mortgages

The Agencies propose to retain the current capital requirements for multifamily mortgages, which provide for a 100 percent risk weight except in the case of certain seasoned multifamily loans that may qualify for a 50 percent risk weight pursuant to the RTC Act. NAHB is very supportive of this treatment as it allows some capital relief for well structured and lower risk multifamily loans. A past due or nonaccrual multifamily loan, whether it initially qualified under the RTC Act or not, will be assigned a risk weighting of 150 percent but this could be reduced to reflect the risk-mitigating impact of collateral and eligible guarantees.

NAHB recommends that the Agencies establish an LTV-based risk-weight continuum for non-RTC Act multifamily mortgages that would parallel the arrangement proposed for home mortgage loans. Credit risk and performance for multifamily loans has shown a relationship to LTV levels that is similar to the pattern found on the single family side of the market. NAHB believes that the Standardized Framework should reflect that relationship.

Institutional Choice of Capital Regulation Frameworks

The Agencies propose to make the Standardized Framework optional for banking organizations that do not use the Advanced Approach to calculate risk-based capital requirements. Under the NPR, a bank that opts to use the Standardized Framework generally would have to notify its primary regulator in writing of its intent to use the new rules at least 60 days before the beginning of the calendar quarter in which it first uses the Standardized Framework. A bank that opts to use the Standardized Framework could return to the general risk-based capital rules by notifying its primary regulator in writing at least 60 days before the beginning of the calendar quarter in which it intends to opt out of the Standardized Framework. The bank would have to include in its notice an explanation of its rationale for this change. Any banking institution that is not required to use the Advanced Approach generally could continue to calculate its risk-based capital requirements using the Basel I framework without notifying its primary regulator. The primary regulator would, however, have the authority to require a bank using Basel I rules to use the standardized or advanced approaches of Basel II if that regulator determines that a particular capital rule is more appropriate in light of the banking organization's asset size, level of complexity, risk profile and/or scope of operations.

NAHB believes that domestic banks should have flexibility to choose the capital framework that best suits a bank's size, business plan and risk profile. Although NAHB endorses the overall concept of the Standardized Framework, we note that it is more complex and will be more costly to implement than the general framework of Basel I. We note that many smaller institutions do not have a need for more risk-sensitive capital requirements and this will allow them to avoid the regulatory burden and cost associated with the Standardized Framework. Thus we support the Agencies proposal to allow banking organizations to remain under the existing Basel I rules if they so choose.

Conclusion

NAHB endorses the Agencies attempts to more closely align bank regulatory capital requirements with an institution's overall risk profile. We believe that the additional risk weight categories under the proposed Standardized Framework allow for greater differentiation across risk exposures without being overly complex or burdensome, a primary goal of the Agencies in developing the framework. We strongly support the Agencies proposal to retain the current statutory risk weightings for pre-sold one-to-four family construction loans and certain multifamily loans. However, we urge the Agencies to consider additional exclusions from the 100 percent category for AD&C loans which have significant risk mitigation features, such as substantial equity and/or pre-sale arrangements. We further urge the Agencies to recognize the benefits of such risk minimizing criteria through additional flexibility in the supervision and examination process. In addition we believe the new capital charges for unfunded commitments should be reviewed to determine the impact on the availability and cost of residential construction finance.

NAHB supports the expansion of risk weights for single-family mortgages based on LTVs and we encourage the Agencies to consider a similar approach for multifamily mortgages. Finally, NAHB supports the Agencies proposal to provide non-Basel II core banks the option to remain under the current Basel I rules or to adopt the proposed Standardized Framework.

Thank you for your consideration of NAHB's views and we invite you to call on us if we can provide additional information.

Respectfully,

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