



ADVOCACY GROUP

William P. Killmer
Group Executive Vice President

March 26, 2007

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Attention: Docket No. 06-15

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. R-1238

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-49

Subject: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Domestic Capital Modifications, 71 FR 247 (December 26, 2006)

Dear Sirs and Mesdames:

On behalf of the 235,000 member firms of the National Association of Home Builders (NAHB), I welcome the opportunity to respond to the Notice of Proposed Rulemaking (NPR) on Basel IA 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 revisions intended to enhance the risk sensitivity of the capital framework that would apply to banks, bank holding companies, and savings associations that are not subject to the proposed Advanced Capital Adequacy Framework (Basel II).

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 small businesses

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with limited capital of their own. These small businesses depend almost entirely upon commercial banks and thrifts for credit. Our surveys show that more than 90 percent of all loans for residential construction, land acquisition and development come from commercial banks and

thrifts. The capital treatment of these types of loans, therefore, governs the cost and availability of housing production credit and is critical to the performance and health of the home building industry. Federally regulated depository institutions also play a major role in financing home purchases and rental housing properties, so the impact of the proposed revisions to 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 have opted instead to work with the Basel Committee on Banking Supervision (Basel Committee) in developing a new version of the Basel Capital Accord. The intent is for the new accord (Basel II) to incorporate advances in risk measurement and management practices, and refine the procedures used to assess capital charges in relation to risk. The Basel II framework will establish capital requirements for the largest, internationally active U.S. financial institutions.

In the process of developing the Basel II standards, the Agencies also began considering whether to revise the current risk-based framework, which would continue to be applicable to the vast majority of U.S. financial institutions. The Agencies believe the Basel I system should be modernized to incorporate greater sensitivity of capital rules to asset risk. In addition, the Agencies grew increasingly concerned that the implementation of Basel II would create a bifurcated regulatory capital framework in the United States, which may result in regulatory capital charges that differ for similar products offered by both large and small banking organizations. Accordingly, the Agencies have issued the Basel IA NPR to seek comments on proposed revisions to the Basel I-based regulations that would apply to U.S. banking organizations that would not be subject to the Basel II system.

NAHB Position

NAHB endorses attempts by the Agencies to refine bank capital requirements so that a bank's capital level is a more precise and direct reflection of its risk profile. In addition, we commend the Agencies efforts to minimize adverse competitive impacts of new bank capital regulations, particularly with respect to the competitive position of smaller, community-based institutions, which continue to be a critical source of credit for home builders and home buyers. NAHB expressed serious concerns over potential adverse impacts on the housing credit system

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of possible revisions to bank capital requirements discussed in the October 25, 2005 Advance Notice of Proposed Rulemaking on Basel IA. We are pleased to see that many of those concerns have been addressed in the Basel IA NPR.

Residential Acquisition, Development and Construction Loans

Under the current Basel I regulations, and pursuant to the Resolution Trust Corporation Refinance, Restructuring and Improvement Act of 1991 (RTCRIA), 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 acquisition, construction and development (AD&C) loans, including pre-sold single family construction loans where the purchase contract is cancelled, are assigned a risk weight of 100 percent. The Agencies propose to retain the current regulatory capital treatment for these types of loans in the proposed Basel IA framework.

NAHB strongly supports and applauds the Agencies' proposal to retain the current statutory risk weights and capital requirements. NAHB believes that this decision is reflective of the Agencies' recognition of appropriate distinctions for the credit risk characteristics associated with AD&C lending as separate and apart from other types of commercial real estate lending.

This decision comports with NAHB's analysis of time series data from the OTS Thrift Financial Report which shows that charge-off rates for residential AD&C loans are significantly lower than for non-residential loans. (We have attached a series of charts and a table with the underlying data that demonstrate the performance of residential AD&C loans compared to other asset categories from 1990 – 2006.) 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. Specifically, NAHB believes 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.

We further urge additional flexibility in aligning bank capital requirements with asset risk through the supervision and examination process to recognize the benefits of credit risk mitigation techniques. The FDIC, OCC and Board recently issued *Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Guidance) wherein flexibility in determining risk mitigation with regard to segmenting portfolios and exposures was noted. Specifically, the Guidance advised that "...institutions are in the best position to segment

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their commercial real estate portfolios and group credit exposures by common risk characteristics or sensitivities to financial, or business developments...institutions should be able to identify potential concentrations in their CRE portfolios by common risk characteristics, which will be differ by property type...factors, such as...level of pre-sold buildings...would be considered in evaluating whether an institution has mitigated the risk posed by a concentration...consideration should be given to the lower risk profiles and historically superior performance of certain types of CRE such as well-structured multifamily housing loans, when compared to others, such as speculative office construction.” Such an approach will be an essential complement to the proposed revisions to the Basel IA framework.

Residential Mortgages

The Agencies’ existing risk-based capital rules 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. 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 capital rules while minimizing the increase in the regulatory burden for banking institutions. The LTV/risk-weight distribution would be as follows:

LTV Ratio (in percent)	Risk Weight (in percent)
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

Loan level private mortgage insurance (PMI) would be reflected in the calculation of LTV if the insurer is not affiliated with the banking organization and meets specified ratings standards.

The Agencies propose to risk weight first lien single family mortgages with nontraditional features in the same manner as all one-to-four family mortgages. The Agencies intend to utilize the examination process to assess bank lending practices for nontraditional mortgages on a case-by-case basis and may require additional capital or reserves when appropriate. The Agencies propose to risk weight privately issued mortgage-backed securities using the risk weights assigned the underlying mortgages under the Agencies’ existing capital rules.

NAHB believes the Agencies approach to risk weighting first lien, one-to-four family mortgages is reasonable. Allowing banking organizations that will not be under the Basel II framework to utilize a capital system that, to some degree, reflects the relatively lower credit risk posed by the majority of home mortgage loans is an important factor in ameliorating the competitive inequities that would otherwise result from the implementation of the Basel II

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system for the larger banking organizations. Basel II sets capital requirements for home mortgages entirely on the basis of institutions' actual risk experience and, thus, will produce a major reduction in capital requirements in that area.

NAHB feels that the Agencies proposal to utilize LTV ratios as the basis for risk weighting first lien, one-to-four family mortgages achieves an effective balance that imbues the home mortgage capital rules with additional risk sensitivity while minimizing burdensome and costly compliance. In addition, NAHB supports the Agencies' intent to use the examination process to assess the need for supplemental capital for single family mortgages with 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.

The Agencies propose to retain the current capital requirements for multifamily residential mortgages, which provide for a risk weighting of 100 percent except in the case of certain seasoned loans that may qualify for 50 percent risk weighting pursuant to RTCRRIA. NAHB recommends that the Agencies establish an LTV-based risk-weight continuum for multifamily mortgages that would parallel the arrangement proposed for home mortgage loans. Credit risk for multifamily loans has shown a relationship to LTV levels that is similar to the pattern on the single family side of the market. NAHB believes that the Basel IA rules should reflect that relationship.

GSE Securities

Under current risk-based capital regulations and the NPR, the Agencies assign a 20 percent risk weight to debt exposures issued or guaranteed by government-sponsored enterprises (GSEs), U.S. banks, and banks located in OECD countries. The Agencies seek comments on whether to use financial strength ratings to determine risk weights for GSE securities. Currently, Fannie Mae and Freddie Mac obtain and disclose separate ratings from Standard & Poor's (risk to the government rating) and Moody's Investors Service (bank financial strength rating). These issuer ratings, collectively known as financial strength ratings (FSRs), evaluate the financial strength of each GSE without regard to any implied financial assistance from the United States government.

The Agencies ask whether the FSRs should be used, where available, and how the rating might be applied. NAHB is strongly opposed to changing the current risk-based capital requirements on GSE securities. First, the current 20 percent risk weight designates an appropriate calculation of risks associated with GSE securities. Furthermore, FSRs are narrowly used and are relatively new. There is no long-term experience with these systems and specifically, no experience during an economic downturn. Second, the NPR would segregate GSEs from banks in the U.S. or in other OECD countries. GSEs would be subject to a higher level of scrutiny than most banks despite the GSEs' securities' low risk. Third, both Basel I and IA use a 20 percent risk weight for securities issued by GSEs, U.S. and OECD banks. Making a distinction for GSE securities between Basel I and Basel IA will cause unnecessary inconsistency and confusion between the two.

Institutional Choice of Capital Regulation Frameworks

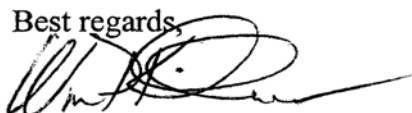
The Agencies are proposing to allow a non-Basel II bank the option to either remain under the current Basel I capital rules or to adopt the proposed Basel IA capital framework, in its entirety. NAHB believes that banks should have the flexibility to choose the capital framework that best suits a bank's size, business plan and risk profile. Thus, we endorse the Agencies proposal to allow banks to remain under the existing Basel I rules if they so choose. We note that many smaller banking institutions do not have a need for more risk-sensitive capital requirements, and this will allow them to avoid the additional regulatory burden and cost associated with implementing the proposed Basel IA framework.

Conclusion

NAHB endorses the Agencies attempts to establish more risk-sensitive capital requirements for non-Basel II banks. As discussed above, we support many of the proposed enhancements in the proposed rule, particularly with regard to AD&C loans, residential mortgages and GSE securities. 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.

NAHB supports the expansion of risk weights for residential mortgages based on LTVs and we encourage the Agencies to consider a similar approach for multifamily mortgages. Further, we support the retention of the current risk weights for GSE securities. Finally, NAHB supports the Agencies proposal to provide non-Basel II banks the option to remain under the current Basel I rules or to adopt the proposed Basel IA capital framework.

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

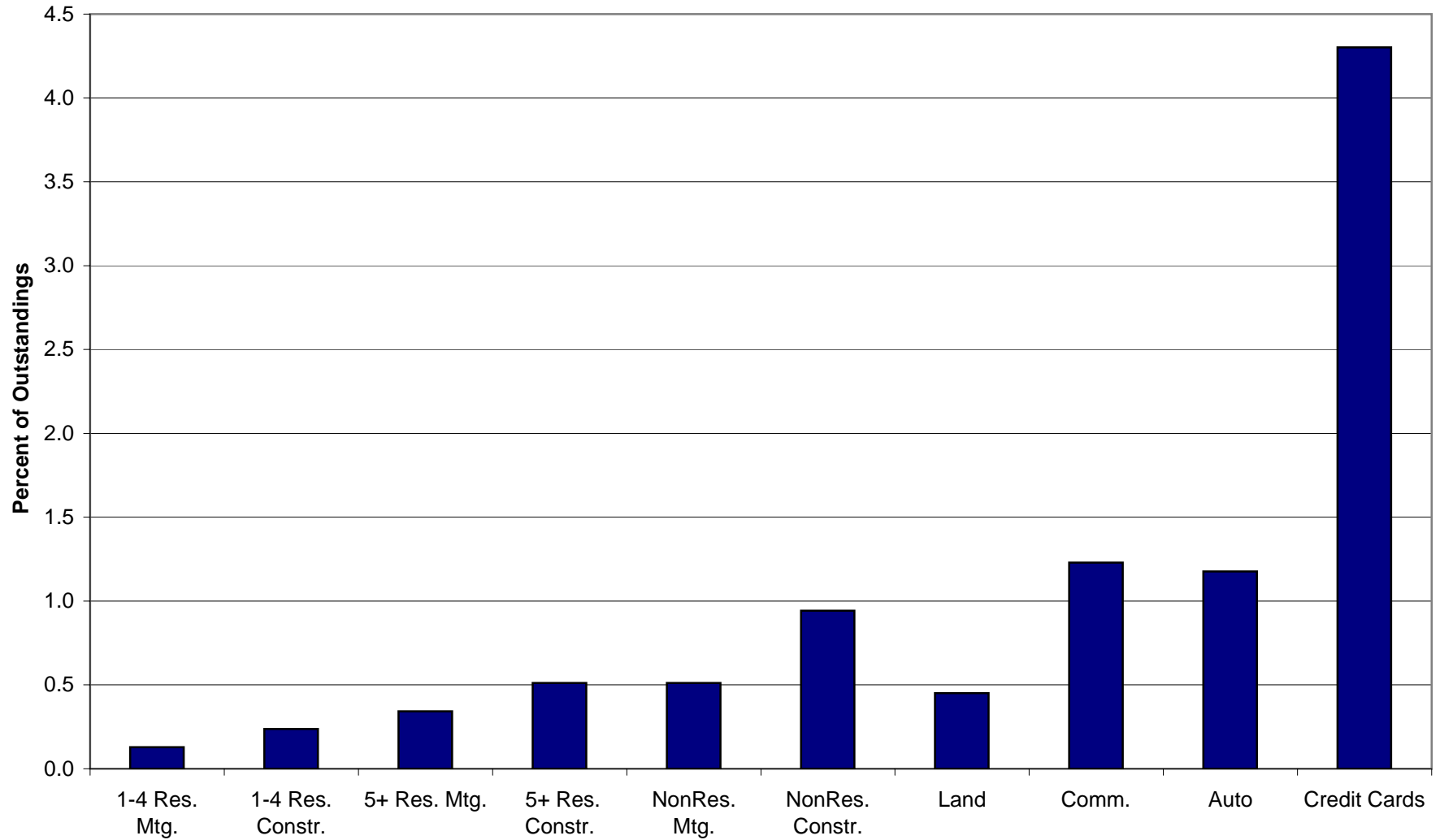
Best regards,

William P. Killmer
Executive Vice President
Advocacy Group

Acquisition, Development and Construction (AD&C) Loan Performance Data

Compiled by:
Regulatory and Housing Policy Area
National Association of Home Builders

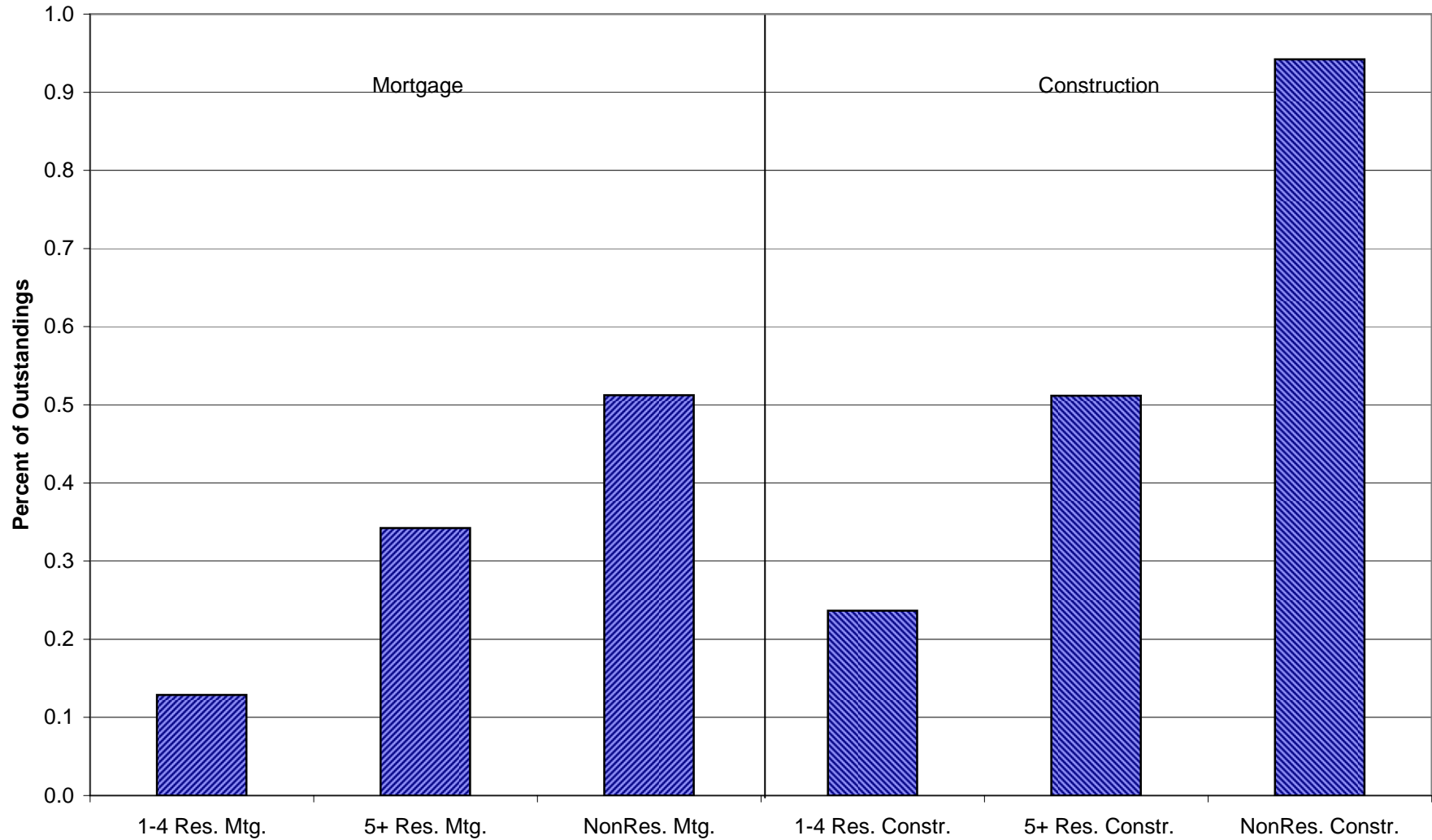


Comparison of Net Chargeoff Rates by Loan Type for All OTS Thrifts
Annual Averages, 1990-2006



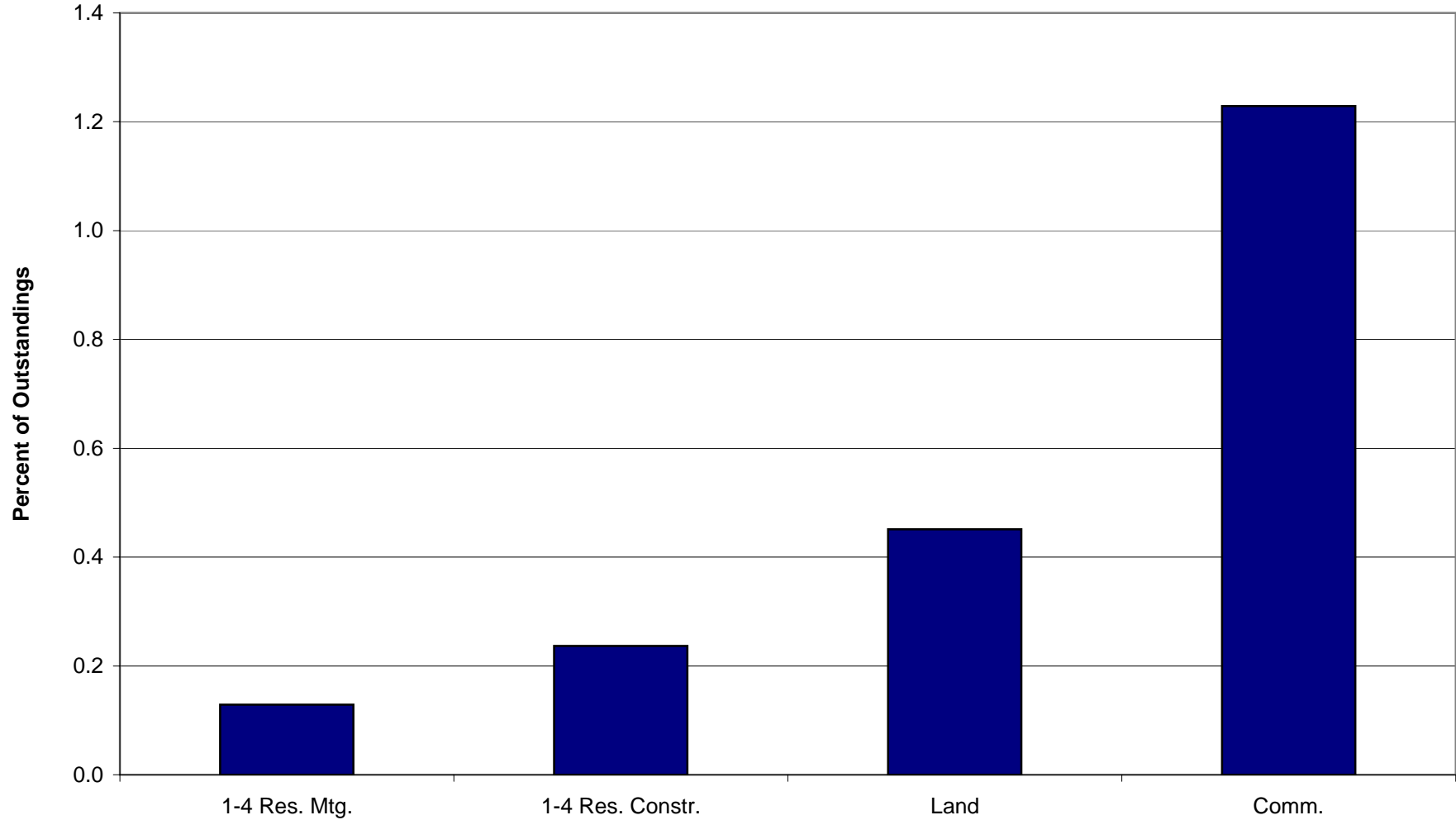
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

Comparison of Mortgage and Construction Loan Net Chargeoff Rates Annual Averages, 1990-2006



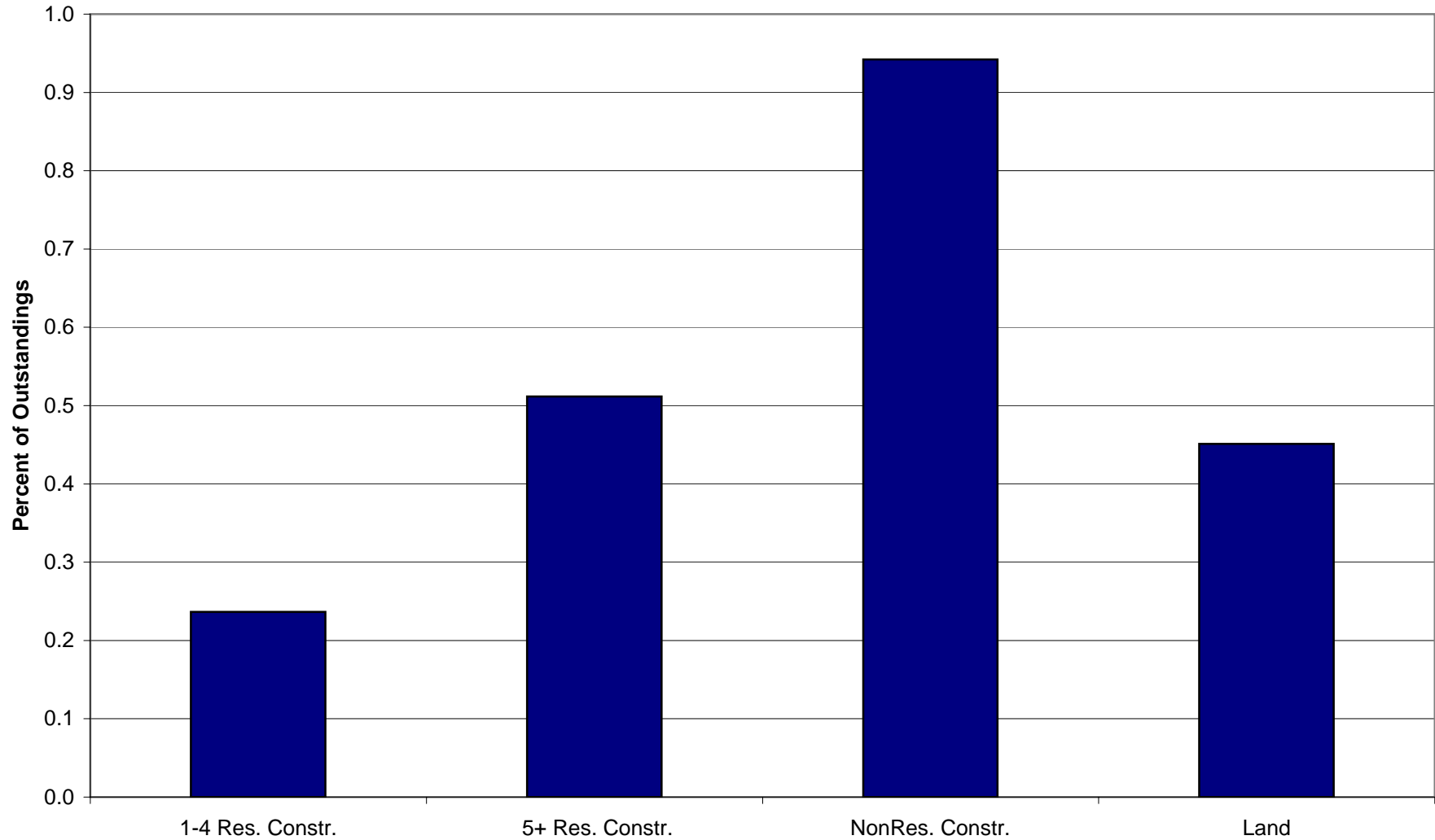
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

**Home Mortgage and Construction Loan Performance
Compared to Land and Commercial Loans**
Annual Averages, 1990-2006



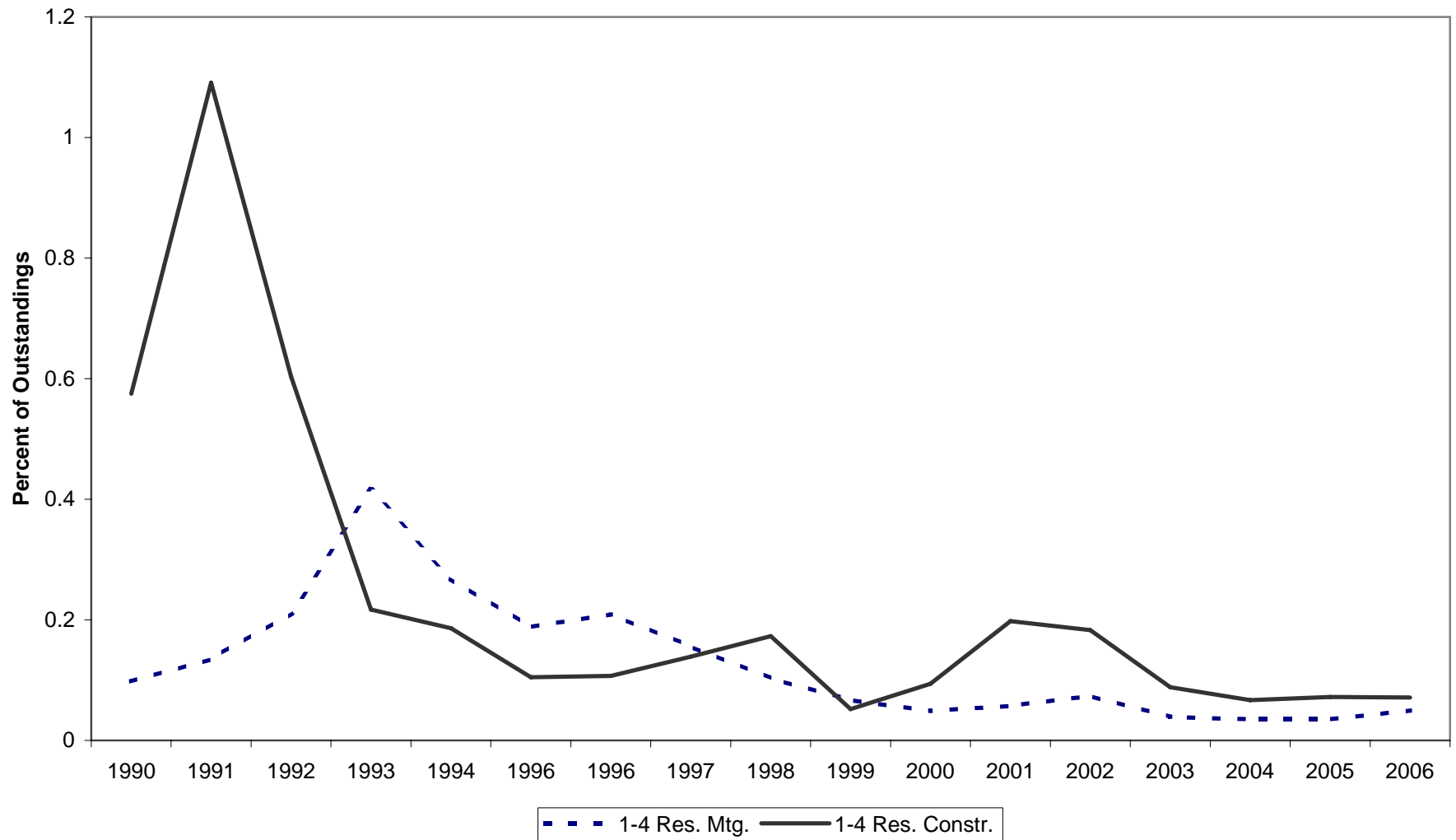
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

Comparison of Construction and Land Loan Net Chargeoff Rates
Annual Averages, 1990-2006



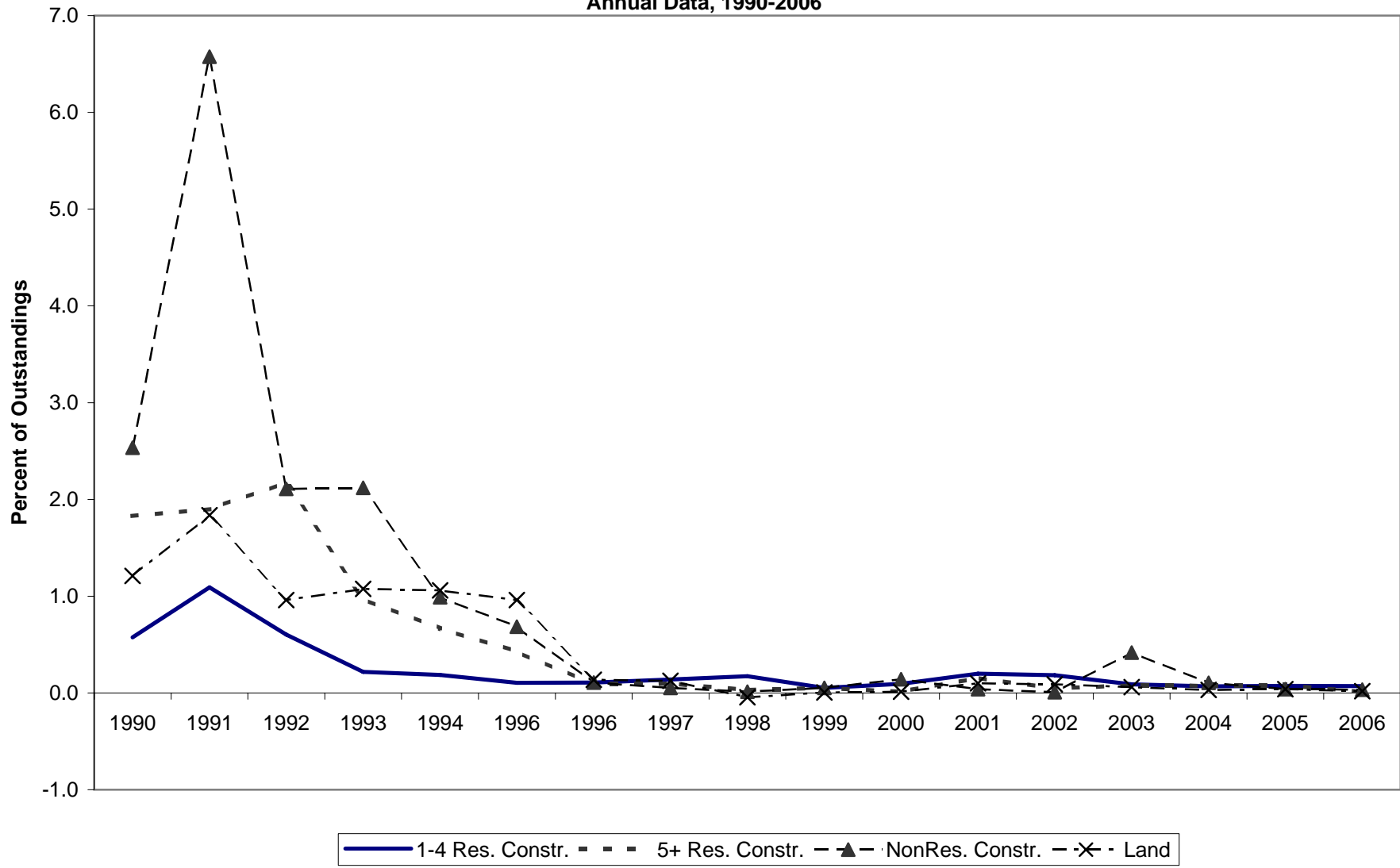
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

Home Mortgage and Construction Loan Performance
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Annual Data, 1990-2006



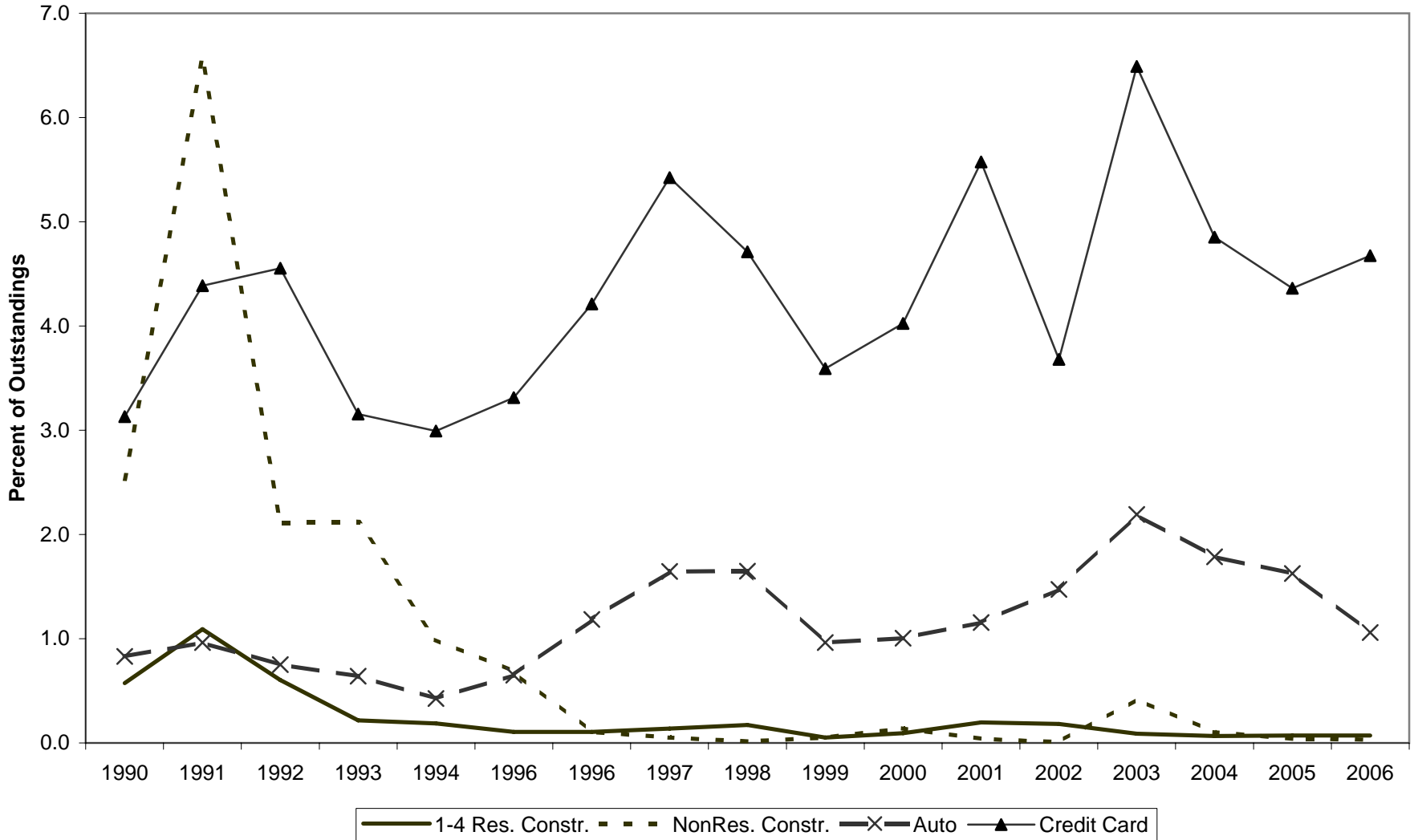
Source: Office of Thrift Supervision, Compiled by NAHB

Comparison of Construction and Land Loan Net Chargeoff Rates
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Annual Data, 1990-2006



Source: Office of Thrift Supervision, Compiled by NAHB

Performance of Home Construction Loans Relative to Other Loan Types
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Annual Data, 1990-2006



Source: Office of Thrift Supervision, Compiled by NAHB

Net Chargeoff as a Percentage of Average Loan Amount

All OTS Thrifts

Annualized from Quarterly Data

Year	Percent of 1-4 Res. Mtg. Mtg. Loans	Percent of 1-4 Res. Constr. Loans	Percent of 5+ Res. Mtg. Mtg. Loans	Percent of 5+ Res. Constr. Loans	Percent of NonRes. Mtg. Mtg. Loans	Percent of NonRes. Constr Constr. Loans	Percent of Land Loans	Percent of Comm. Loans	Percent of Auto Loans	Percent of Credit Card Loans
1990	0.098	0.575	0.835	1.829	1.389	2.533	1.208	1.310	0.829	3.131
1991	0.135	1.091	0.610	1.898	1.166	6.574	1.836	2.190	0.963	4.386
1992	0.211	0.603	0.724	2.176	1.321	2.110	0.960	1.455	0.751	4.554
1993	0.416	0.217	0.844	0.971	1.629	2.119	1.076	3.067	0.641	3.154
1994	0.268	0.186	1.446	0.667	1.168	0.989	1.059	0.902	0.426	2.993
1996	0.188	0.105	0.644	0.427	0.781	0.684	0.959	0.674	0.651	3.312
1996	0.209	0.107	0.524	0.088	0.392	0.106	0.135	0.314	1.185	4.212
1997	0.156	0.139	0.183	0.098	0.084	0.052	0.126	0.382	1.646	5.424
1998	0.103	0.173	0.068	0.032	0.087	0.014	-0.045	0.447	1.648	4.711
1999	0.067	0.052	-0.069	0.053	0.042	0.052	0.006	0.473	0.964	3.592
2000	0.049	0.094	-0.033	0.013	0.040	0.141	0.012	0.946	1.004	4.024
2001	0.057	0.198	0.001	0.155	0.188	0.040	0.100	1.348	1.155	5.575
2002	0.074	0.183	-0.002	0.048	0.086	0.007	0.089	2.125	1.472	3.679
2003	0.039	0.088	0.007	0.078	0.081	0.418	0.061	1.247	2.191	6.489
2004	0.035	0.067	0.013	0.073	0.113	0.104	0.032	1.387	1.785	4.851
2005	0.035	0.072	0.013	0.081	0.071	0.039	0.038	1.470	1.626	4.362
2006	0.05	0.071	0.012	0.011	0.070	0.033	0.019	1.158	1.059	4.675
Average	0.129	0.237	0.342	0.512	0.512	0.942	0.451	1.229	1.176	4.301