The Real Estate Roundtable

September 13, 2006

The Honorable Spencer C. Bachus
Chairman, Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515-6051

Re: A Review of Regulatory Proposals on Basel Capital
and Commercial Real Estate

Dear Mr. Chairman:

The Real Estate Roundtable (www.rer.org) is pleased to provide comments in conjunction with the Subcommittee on Financial Institutions and Consumer Credit September 14, 2006 hearing on *A Review of Regulatory Proposals on Basel Capital and Commercial Real Estate*. We would like to commend the Committee for their work toward examining the regulatory proposals on the New Basel Capital Accord ("the New Accord") and the proposed guidance on "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" ("the Guidance").

The Real Estate Roundtable supports the efforts of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively, "the Agencies") to ensure the safety and soundness of the banking system and, in particular the stability of the commercial real estate markets. We also support efforts to more closely align regulatory capital with economic capital and implement a more consistent conceptual risk capital framework in our global financial services system through the New Accord.

However, we also have serious concerns about ensuring that these measures do not result in any significant unintended consequences — both for the commercial real estate sector and the overall economy. The Roundtable urges the Agencies, and this Committee, to monitor closely the manner in which the Guidance and the New Accord are applied and administered throughout the United States in order to ensure that no unintended and destabilizing consequences occur in any individual local markets that might undermine their goal of ensuring continued economically sound lending.

The Real Estate Roundtable and its members lead an industry that generates more than 20 percent of America's gross national product, employs more than 9 million people, and produces nearly two-thirds of the taxes raised by local governments for essential public services. Our members are senior real estate industry executives from the U.S.'s leading income-producing real property owners, managers and investors; the elected heads of America's leading real estate trade organizations; as well as the key executives of the major financial services companies involved in financing, securitizing, or investing in income-producing properties.

1420 New York Avenue, N.W. • Suite 1100 • Washington, DC 20005 • Phone: 202-639-8400 • Fax: 202-639-8442 • www.rer.org

The Real Estate Roundtable strongly supports the Agencies' efforts to promote economically responsible commercial real estate lending that reflects sound underwriting and risk management practices. In this regard, the Roundtable firmly believes that banks should not be treated punitively for making sensibly underwritten acquisition, development, and construction loans. But we also share the Agencies' concern that rapid growth in the commercial real estate portfolios of certain institutions, and attendant weaknesses in control and reporting practices, may have resulted in some uneconomic lending that could threaten both the safety and soundness of the institutions involved and the proper functioning of the commercial real estate market. Thus, the Roundtable does not advocate regulatory policy that allows uneconomic lending on real property that is not appropriately collateralized or not supported by adequate pre-sales or pre-leasing.

Rather, we support regulatory policy that encourages sound lending standards by which real estate loans are sensibly underwritten, economic risk is rationally priced, and loans are appropriately collateralized with substantial equity and/or adequate presales or pre-leasing. Within this context, we believe that the proposed Guidance constitutes a prudent step to ensure that the commercial real estate lending market continues to function with the appropriate level of discipline.

The risk management principles and capital adequacy guidelines outlined in the Guidance appear to reflect best practices to which all U.S. depository institutions are already expected to adhere in connection with their commercial real estate lending activities. It is therefore our understanding that the Guidance does not impose new requirements on institutions found to be heavily concentrated in commercial real estate lending. Rather, the Guidance reiterates existing requirements applicable to all financial institutions and calls on identified institutions and their examiners to pay special attention to such requirements as they apply to the institutions' real estate loan portfolios.

Bank underwriting standards have improved since the last economic cycle, resulting in more realistic loan-to-value requirements, more accurate estimates of future cash flows, and more proactive management of non-performing assets. In addition, federal regulatory agencies have provided stronger regulatory oversight of the sector. Real estate's increasing role in global capital markets – through securitization vehicles such as commercial mortgage backed securities (CMBS) and real estate investment trusts (REITs) — has led to greater transparency, enhanced liquidity, better discipline and more exacting scrutiny of commercial real estate asset quality. As a result, the process for disclosing market information has become more defined, the quality of information required by both regulators and investors has improved, and the speed with which property performance information is available has accelerated.

Although the Real Estate Roundtable does not have an objection to the Guidance itself in its present form, we believe the Agencies should take appropriate steps to actively monitor the application and administration of the Guidance by their supervisory personnel throughout the country. As the Agencies are well aware, overzealous or inconsistent application and enforcement of the Guidance could lead to unintended consequences for the commercial real estate market and, in turn, for those depository institutions the Guidance is meant to protect.

Commercial Banks Vital to Real Estate Credit Availability

Commercial banks constitute one of our nation's largest source of commercial and multifamily real estate financing. A sudden and significant contraction of bank credit available for commercial real estate could lead to a decline in property values and in the economic condition of existing borrowers. Such a decline would, in turn, reduce the quality of outstanding loans and thus threaten the health of banks that are significantly concentrated in commercial real estate, which would likely lead such banks to further curtail credit. Unfortunately, we have experienced such vicious cycles in the past and seen the consequences for our economy as a whole. This experience underscores the importance of ensuring that the Guidance is applied and administered with care; otherwise, the Guidance can become a self-fulfilling prophecy, inducing the very same consequences it seeks to prevent. It is also important for the Committee to ensure that the any new capital standards for commercial real estate established by the New Accord do not unsettle, or substantially disrupt, real estate credit.

The U.S. commercial real estate market has proven to be strong and a key driver of our economy. Accordingly, it is vital that the Agencies appropriately monitor the application and administration of the Guidance to ensure that such application and administration is balanced, consistent and otherwise conforms to the Agencies' intentions. As one element of such monitoring, the Roundtable respectfully suggests that the Agencies sponsor periodic industry forums. These forums would permit institutions, their customers, and other interested parties to provide feedback to the Agencies on the implementation of the Guidance in the field. Such forums, held on a quarterly or semiannual basis, could serve as an early warning system to alert the Agencies regarding potential issues with respect to the administration and implementation of the Guidance. This feedback would allow the Agencies to address appropriately any possible overreaction to the Guidance by supervisory personnel or by the institutions they supervise that might threaten the soundness of the banking system or the stability of the real estate lending market on which such soundness depends in significant part.

We trust the Committee may find our comments useful. Should you have questions or require additional information, please contact Clifton E. Rodgers, Jr. by telephone at (202) 639-8400 or by email at crodgers@rer.org.

Thank for this opportunity to comment on this important issue.

Sincerely,

Jeffery D. DeBoer
President and Chief Executive Officer