



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. 06-09

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: RIN 3064-AC73

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-1261

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-33

**Subject: Risk-Based Capital Standards: Advanced Capital Adequacy Framework, 71
FR 185 (September 25, 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 II 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 U.S. bank capital rules through an Advanced Capital Adequacy Framework (Basel II) that will be a requirement or option for banking organizations meeting specific qualifying criteria. The qualifying criteria are designed to identify the largest, internationally active banking organizations.

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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 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. banking organizations. Under the proposed framework, qualifying banking organizations will use risk parameters determined by their internal systems to calculate credit risk capital requirements. These institutions will also be required to use internal estimates of operational risk to generate an operational risk capital requirement. A separate system, Basel IA, is under development to provide a more risk-sensitive capital framework for banking organizations that operate outside of the Basel II sphere.

NAHB Position

NAHB continues to endorse 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. NAHB expressed serious concerns over potential adverse impacts on the housing credit system of possible revisions to bank capital requirements discussed in the August 3, 2003 Advance Notice of Proposed Rulemaking on Basel II. We also expressed strong reservations on possible 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. We are pleased to see that many of those concerns have been addressed in the Basel II and Basel IA NPRs.

Residential Acquisition, Development and Construction Loans

Under the proposed Basel II framework, residential acquisition, development and construction (AD&C) loans generally would fall under the wholesale exposure category. The Agencies have proposed two subcategories of wholesale exposures – high volatility commercial real estate (HVCRE) and non-HVCRE. HVCRE exposures would be subject to a risk-based capital (RBC) formula that would produce higher required capital than for non-HVCRE exposures. Excluded from the definition of HVCRE loans are 1) AD&C loans on one-to-four family residential properties; and 2) commercial real estate projects with loan-to-value (LTV) ratios less than or equal to the maximum supervisory LTV ratio and where the borrower has contributed at least 15 percent equity prior to the first advance and the equity contribution remains through the life of the project.

The Agencies also propose to retain the current regulatory capital treatment for pre-sold one-to-four family residential construction loans and certain multifamily loans as mandated by the Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (RTCRRIA). Under the RTCRRIA, pre-sold one-to-four family residential construction loans and certain multifamily loans meeting statutory requirements, must be assigned a 50 percent risk weight. Pre-sold residential construction loans where the purchase contract has been cancelled are assigned a 100 percent risk weight. AD&C loans that do not qualify for the statutory or other exceptions will be treated as HVCRE wholesale loans and will be risk weighted according to the higher-risk RBC formula.

NAHB strongly supports the Agencies proposal to retain the current statutory risk weights for pre-sold one-to-four family construction loans and certain multifamily loans. Moreover, we do not believe that additional underwriting criteria should apply to such loans, nor should banks be required to confirm the appropriateness of these risk weightings through their internal RBC formulas as the Agencies have questioned. Such requirements are inconsistent with the intent of the RTCRRIA provisions, redundant and would be an unnecessary regulatory burden.

NAHB also supports the proposed exclusion of one-to-four family AD&C loans from the HVCRE definition. 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.

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However, we urge the Agencies to make additional distinctions among the different forms of real estate loans in the HVCRE category. We believe that additional exclusions from the HVCRE definition 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 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 presold 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 II framework.

Residential Mortgages

As noted, NAHB endorses the Agencies' attempts to more closely align bank regulatory capital requirements with an institution's overall risk profile. Analysis by the Agencies and others shows that the largest reductions in regulatory capital from the application of the proposed capital framework in the NPR would be in the residential mortgage and mortgage-backed securities (MBS) areas. For example, the results from the Agencies' Fourth Quantitative Impact Study (QIS-4) found that the median risk weight for residential mortgages under Basel II would fall to 16 percent, compared to 50 percent under Basel I. Similarly, the Basel II median risk weight for Fannie Mae and Freddie Mac MBS would be 7 percent, compared to 20 percent under Basel I. NAHB strongly supports the reduction in capital requirements as reflected in these results due to the more appropriate alignment of regulatory capital commensurate with the lower risk exposure of residential mortgages and MBS.

Institutional Choice of Capital Regulation Frameworks

The Basel II regime that the Agencies have proposed would require that Basel II banks use the Advanced Approach outlined in the NPR. In contrast, foreign banks have the option of using the Advanced Approach or the Standardized Approach as described in the June 2004 Basel Committee's text of the Basel II New Accord. Several core banks, trade associations, regulators

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and members of Congress have raised concerns that not allowing U.S. banks the option of using the Standardized Approach could result in competitive inequities between domestic Basel II banks and their foreign counterparts.

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 Advanced Approach, we note that it is extremely complex and will be more costly to implement than the Standardized Approach. Similar to the current Basel I and proposed Basel IA rules, the Standardized Approach calculates capital requirements based on supervisory risk weightings for different asset types. The Standardized Approach has more finely tuned risk weightings than Basel I, but not as differentiated as Basel IA. For example, under the Standardized Approach all residential mortgages would have a 35 percent risk weighting, compared to 50 percent under Basel I and the six LTV-calibrated risk weights under Basel IA. Additionally, all commercial real estate (including residential AD&C and multifamily mortgages) would be assigned a 100 percent risk weighting, without exclusion.

To ameliorate any possible competitive disadvantages for U.S. Basel II banks, NAHB believes that these banks should be given the option of using the Standardized Approach. However, NAHB strongly urges that if such an option is allowed that the statutory risk weights for pre-sold one-to-four family construction loans and multifamily mortgages be preserved.

Conclusion

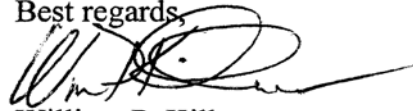
NAHB endorses the Agencies attempts to more closely align bank regulatory capital requirements with an institution's overall risk profile. We support many of the proposed enhancements in the proposed rule, particularly with regard to AD&C loans. We strongly support the Agencies proposal to retain the current statutory risk weightings for pre-sold one-to-four family construction loans and certain multifamily loans. In addition, we support the proposed exclusion of one-to-four family AD&C loans and certain commercial real estate loans from the HVCRE definition. However, we urge the Agencies to consider additional exclusions from the HVCRE category for 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 also stands ready to work with the Agencies to explore various options to implement the Basel II Capital Accord in a manner that does not create competitive inequities for domestic Basel II banks, including the option to use the Standardized Approach. However, the statutory risk weights for pre-sold one-to-four family construction loans and certain multifamily loans must be preserved under any alternative approach.

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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,

A handwritten signature in black ink, appearing to read 'W. Killmer', with a long, sweeping horizontal stroke extending to the right.

William P. Killmer
Executive Vice President
Advocacy Group

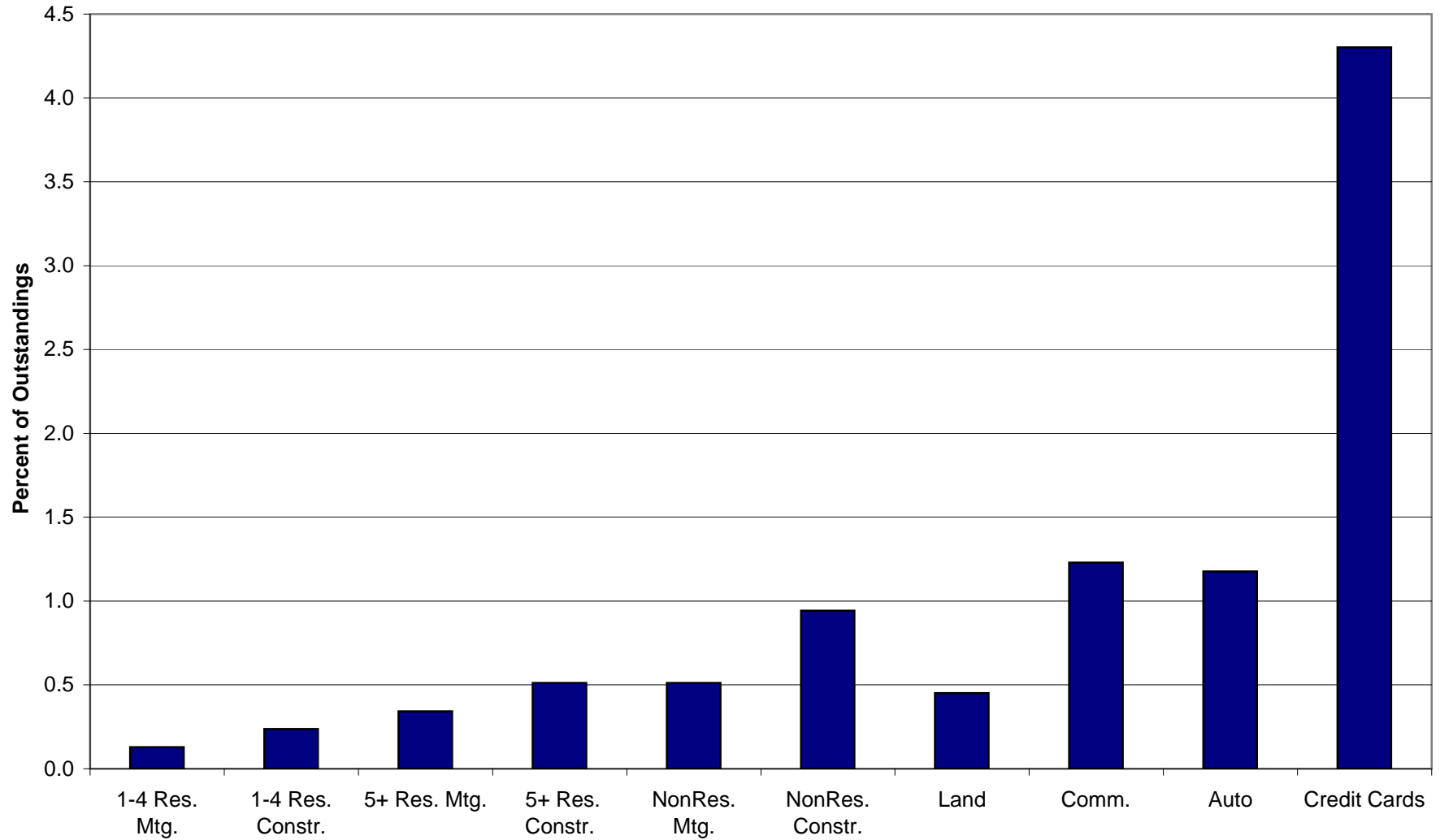
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Attachment

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

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

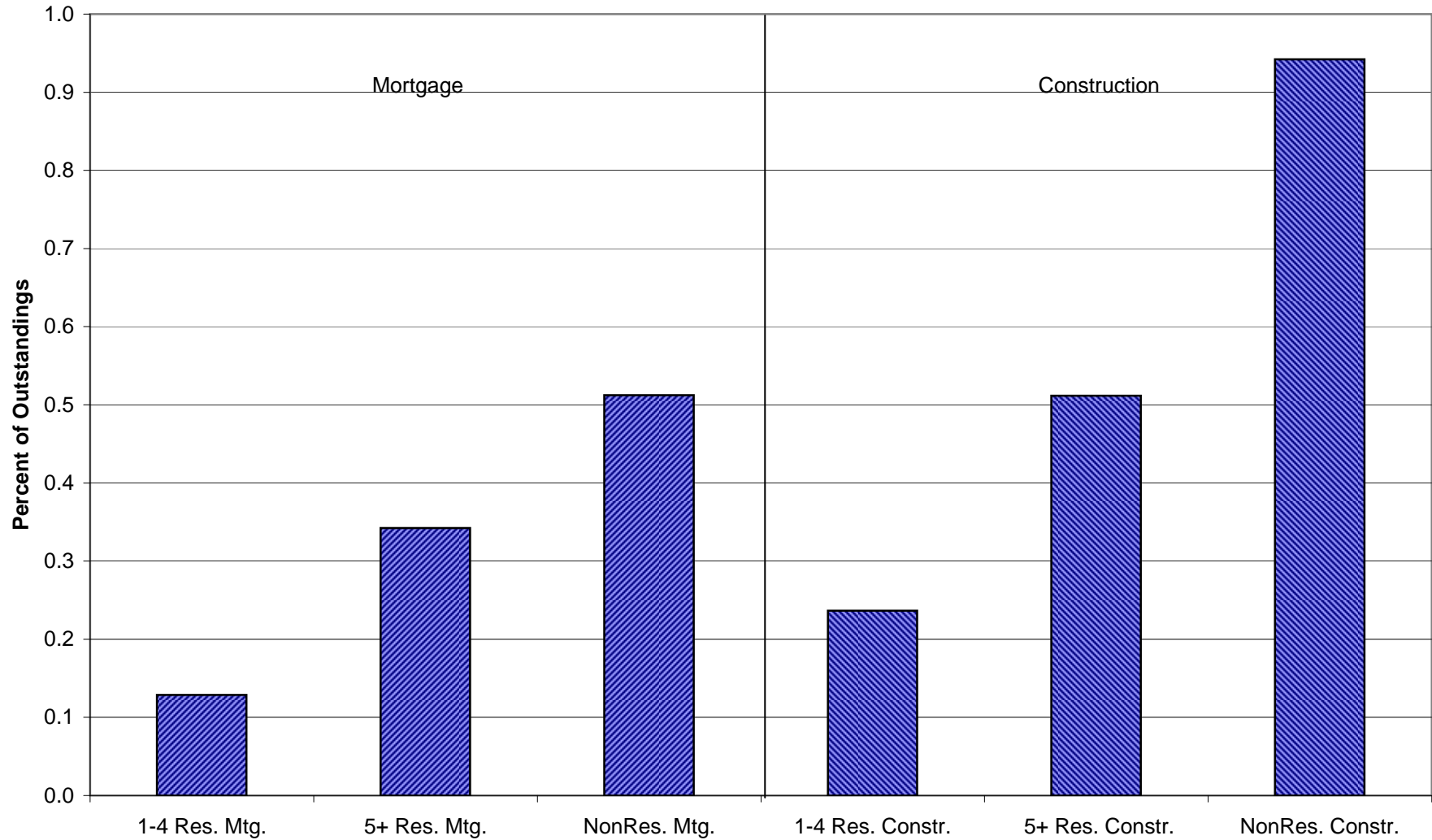


Comparison of Net Chargeoff Rates by Loan Type for All OTS Thrifts
Annual Averages, 1990-2006



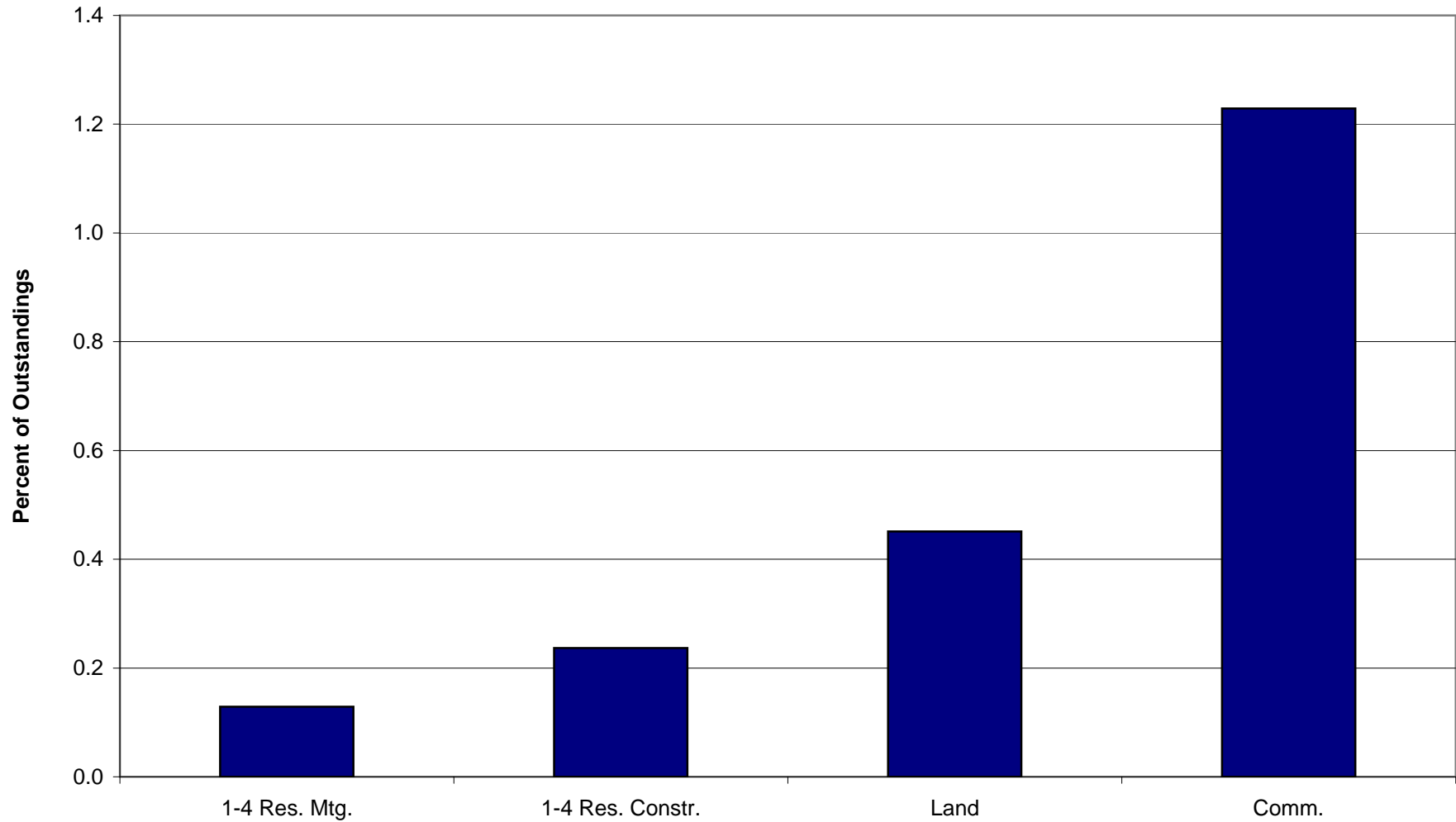
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

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



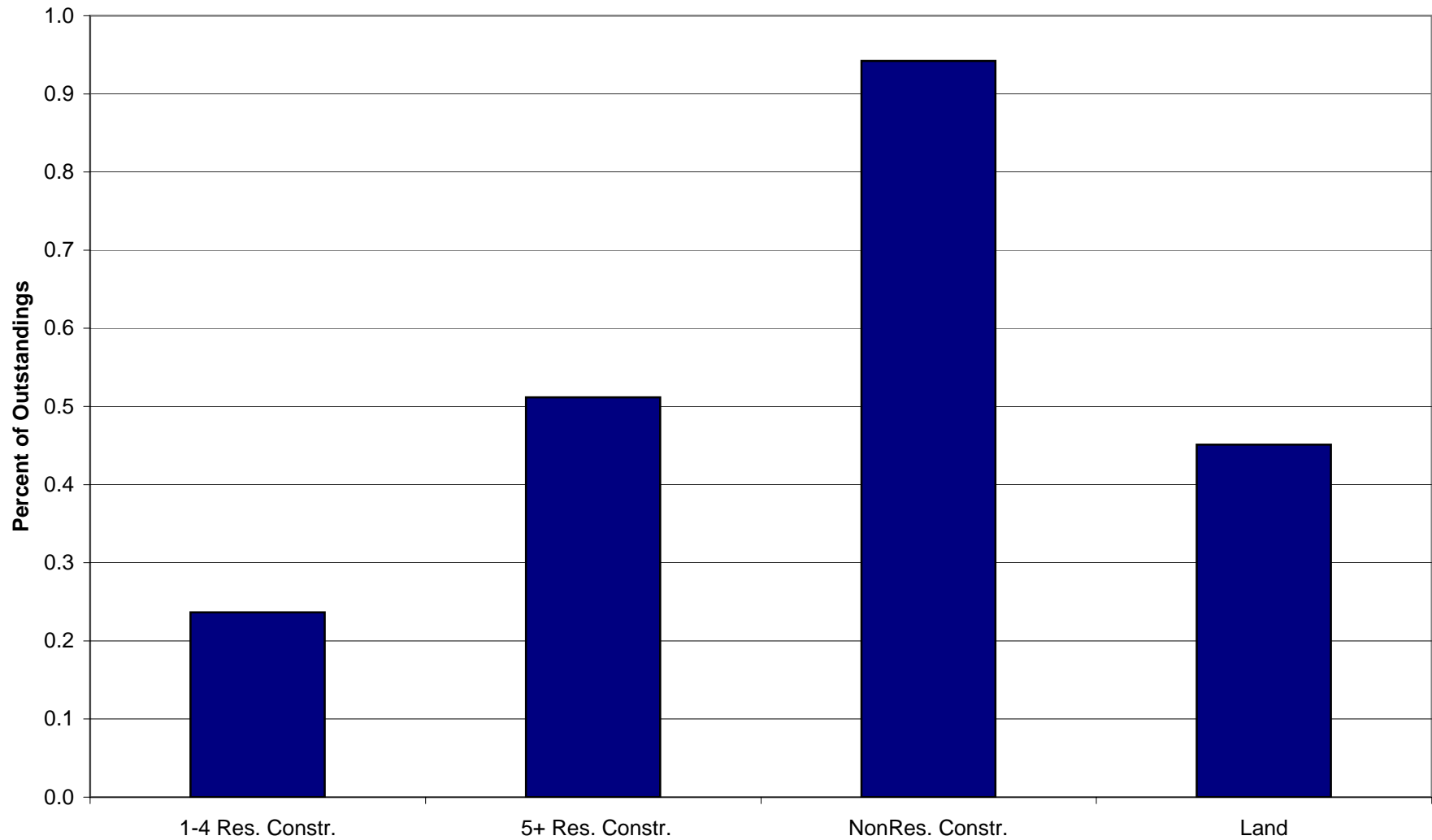
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

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



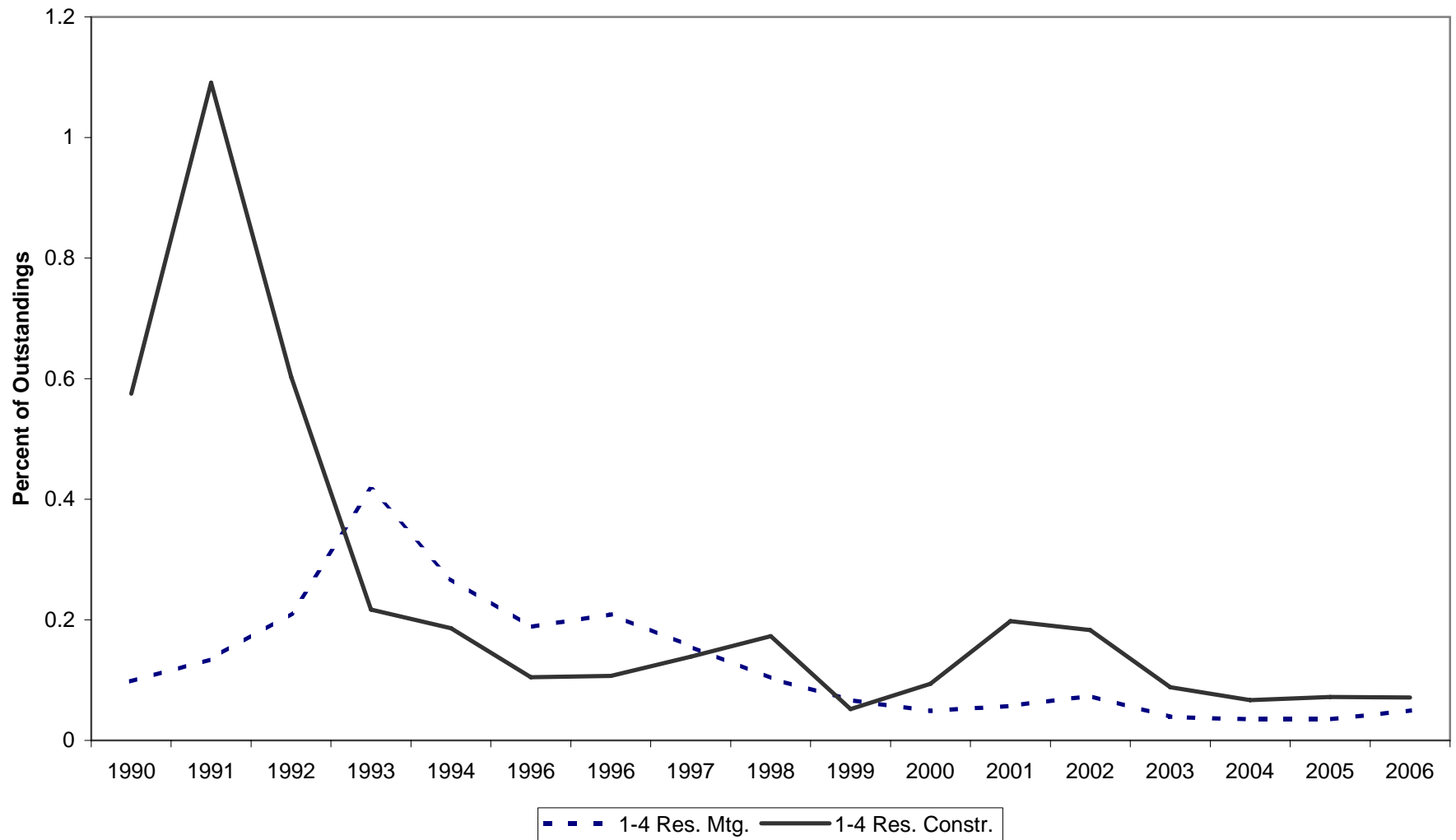
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

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



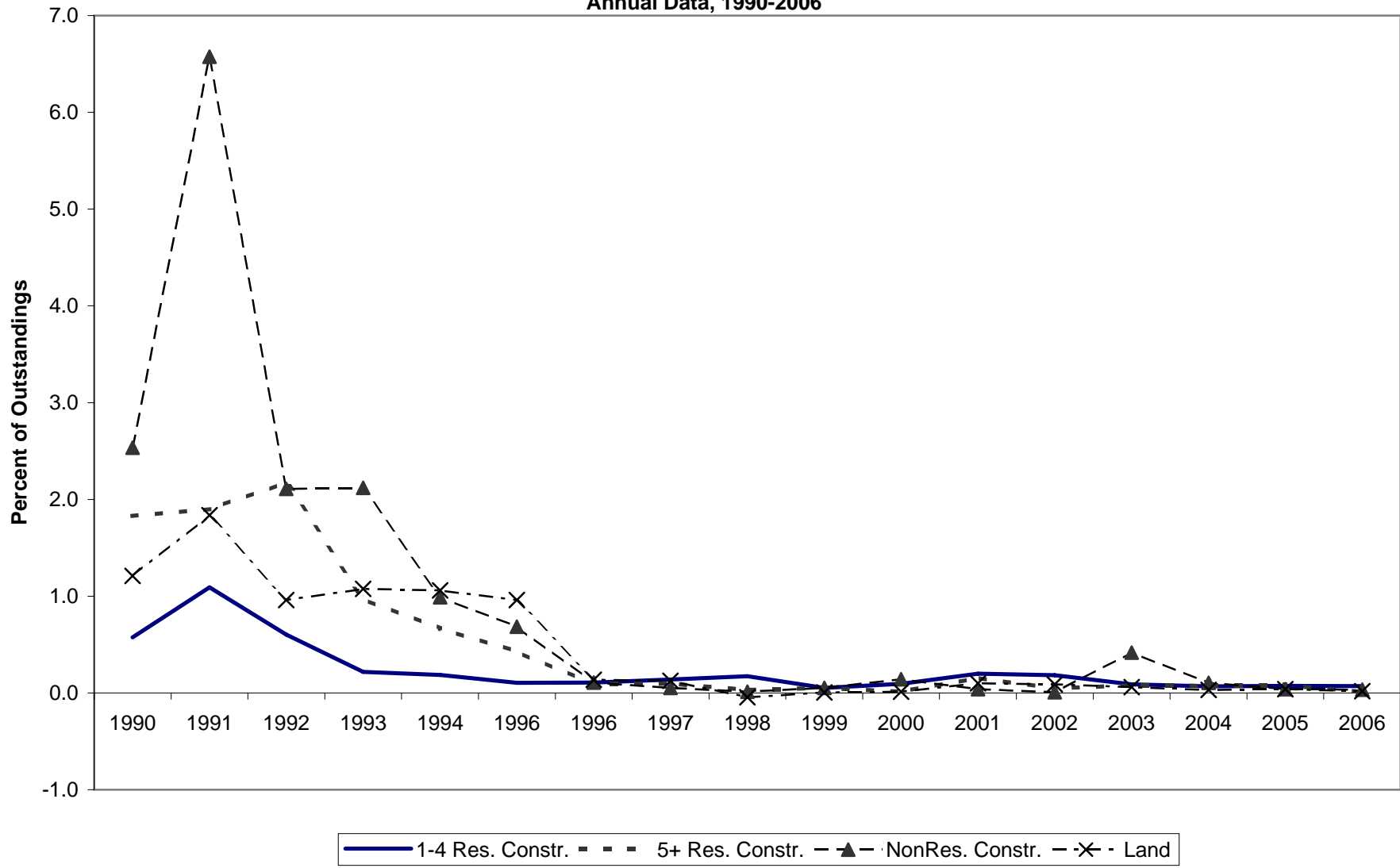
Savings and Loan Net Chargeoffs as Percent of Average Outstanding Loans
Source: Office of Thrift Supervision, Compiled by NAHB

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