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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Switzerland

RE: Commercial Real Estate Provisions of the New Basel Capital Accord

Ladies and Gentlemen:

On behalf of the more than 18,000 members of the Appraisal Institute we are pleased to provide our response to the *Third Consultative Paper of the New Basel Capital Accord* ("Accord") issued for comment on April 29, 2003.

We recognize that movement toward transparency and harmonization as evidenced in the Accord is a necessary step toward enhancing international commerce and bringing emerging markets into the global marketplace more effectively. We also applaud the Basel Committee's commitment to developing a more balanced, consistent, and risk-sensitive capital framework. We are, however, concerned about the unintended consequences of the new Accord, especially insofar as they relate to the mortgage and commercial real estate markets.

Our primary concern is the Accord's weighting system, which singles out real estate, requiring a much higher risk weighting for collateralization, especially in regards to so-called High Volatility Commercial Real Estate (HVCRE). It is our understanding that regulatory capital requirements for commercial real estate (CRE) loans will vary under the New Accord. While the capital required for residential mortgage holdings would be reduced, it would be increased for those institutions with significant concentrations in certain acquisition, development and construction loans that lack "substantial equity" or are not "sufficiently pre-leased" — in other words, the HVCRE loans. We encourage you to further refine, with industry input, the terms "substantial equity" and "sufficiently pre-leased" in order to clarify the definition of HVCRE to ensure that properties are fairly categorized and weighted. One measurement of substantial equity could be the supervisory loan-to-value limits for real estate loans as defined by the requirements of Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

Basel II risk weights assigned to certain Income Producing Real Estate (IPRE) and HVCRE categories appear to be excessive and we therefore recommend that they be reconsidered. Naturally we are in favor of any policy that prevents lending on real property that is not appropriately collateralized or that lacks adequate borrower equity, property pre-sales or pre-leasing—particularly under adverse or uncertain market conditions. That being said, we would not want to see banks penalized for making prudently underwritten loans, especially HVCRE loans, where appropriate.

The Appraisal Institute recommends that the Accord be structured to offer incentives to banking institutions to adopt more comprehensive underwriting practices and technologies or permit national banking regulators to adopt such incentives. Specifically we would suggest that banks be encouraged to adopt comprehensive underwriting and credit scoring practices to evaluate commercial real estate and tenant creditworthiness; to increase the use of lease-based valuation software; and to assess the risk in their portfolios by valuing commercial real estate held in portfolio on a quarterly or semi-annual basis, especially during times of market instability. As part of these more robust underwriting practices, financial institutions should be encouraged to use independent, well-educated, and highly qualified real estate appraisers, and qualified valuers to help validate their own internal underwriting and valuation procedures and periodically verify their determinations of value.

The Appraisal Institute is an international membership association of professional real estate appraisers, with more than 18,000 members in the United States and abroad. Its mission is to promote the profession of real estate appraisal and to uphold professional credentials, standards of professional practice, and ethics consistent with the public good. As the leader in appraisal and valuation education, research, publishing, and professional membership designation programs, the Appraisal Institute plays an active role in the international finance system. We regularly work to increase the dialogue and educate policy makers on the importance of sound appraisal standards, qualifications and enforcement systems. Our members, particularly our designated members, help set the bar for valuation practices in the United States and around the world and play an integral part in maintaining the integrity, health and transparency of the real estate markets.

Thank you for considering our comments. Should you have any questions, please contact Don Kelly, Vice President of Public Affairs, at 202-298-5583 or dkelly@appraisalinstitute.org.

Sincerely,

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