The Real Estate Roundtable

July 31, 2003

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002, Basel, Switzerland
bcbs.capital@bis.org
Fax: +41 61 / 28081 88

Re: Request for Comments on the Third Consultative Paper on the New Basel Capital Accord

Ladies and Gentlemen:

The Real Estate Roundtable (*www.rer.org*) is providing commentary to the Basel Committee on Banking Supervision (Committee) on the *The Third Consultative Paper on the New Basel Capital Accord* issued for comment on April 29, 2003.

The New Accord could have a significant impact on the flow of credit to the commercial real estate industry and, thereby, affect its overall liquidity and valuation. As such, we appreciate the opportunity to provide the Committee, as well as the U.S. banking regulatory agencies, with our concerns about the New Basel Capital Accord (New Accord), and the Third Consultative Paper (the Third Paper).

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 US'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.

The Real Estate Roundtable (the Roundtable) would like to commend the Committee for its work toward a more fair and consistent conceptual risk capital framework. By more closely aligning regulatory capital with economic capital, the New Accord should improve the relative allocation of capital to more closely reflect actual differences in risk. While the Roundtable believes that the New Accord makes significant progress toward greater risk transparency, we have certain concerns about the potential for significant unintended consequences — both for the real estate sector and the overall economy — that an inappropriately calibrated new regulatory capital regime can generate.

It is our understanding that regulatory capital requirements for commercial real estate (CRE) loans will vary under the New Accord, reducing the capital required for residential mortgage holdings, and increasing the required capital to be held by those institutions with significant concentrations of certain acquisition, development and construction loans (ADC) loans that lack "substantial equity" or are not "sufficiently pre-leased" — also known as "high volatility commercial real estate" (HVCRE) loans. Additionally, we are pleased to learn that the Federal Reserve intends for most sensibly underwritten ADC loans — as well as CRE lending on in-place properties — to be accorded low asset correlation treatment and thereby receive lower capital requirements than our original analysis suggested. Concerns remain, however, that regulatory capital could increase under the IRB approach for many of the nation's larger institutions with high concentrations of HVCRE loans.

The Roundtable does not support regulatory policy that encourages uneconomic lending on real property that is not appropriately collateralized or with inadequate pre-sales or pre-leasing — particularly in weak real estate markets and during times of economic contraction. For example, if, in fact, the New Accord only increases the regulatory capital for HVCRE loans and not CRE loans across the board, the Roundtable would not express opposition to this aspect of the New Accord. However, where appropriate, banks should not be treated punitively for making sensibly underwritten ADC loans. To the extent that we can work with the Basel Committee and Federal Reserve staff to clarify the terms "substantial equity" and "sufficiently pre-leased" we would welcome the opportunity.

Commercial Mortgage-Backed Securities

Real estate's increasing role in global capital markets has led to greater transparency, enhanced liquidity, better discipline and more exacting scrutiny of CRE asset quality. In the U.S., nearly 14 percent of the CRE debt and nearly 40 percent of CRE equity has been securitized, primarily through the commercial mortgage-backed security (CMBS) and real estate investment trust ("REIT") vehicles — up from an estimated 5% in 1990. In fact, CMBS is now the second largest source of U.S. CRE debt. 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.

While commercial bank financing is the single largest source of credit for the U.S. commercial and multifamily real estate markets, commercial mortgage-backed securities ("CMBS") are the second largest source of CRE debt. CMBS create liquidity for long-term commercial and multifamily mortgages and real estate domestically and internationally. The total U.S. CMBS market is currently estimated to be $360 billion. Another concern we have about the New Accord's impact on CRE liquidity is the regulatory capital requirements for CMBS. The loans backing these securities are collateralized by income producing properties that typically generate sufficient net operating income to create appropriate debt service and loan to value ratios to be considered in the low asset correlation category. For this reason, we are not clear on why CMBS are treated differently than the underlying loans would be if they were not securitized – with regulatory capital increases estimated at between 100 and 120 percent for originators.

The Third Consultative Paper

Despite proposed revisions in the capital charges on certain types of commercial and multifamily real estate (CRE) loans contained in the Third Consultative Paper, we urge the Committee to develop a more comprehensive assessment of the number of banks that are affected by the New Accord, the concentration of CRE loans at these institutions, and to conduct a study on the impact of the New Accord on the "business" of CRE lending and the potentially adverse impact the New Accord could have on credit availability to this sector. We also urge you to further refine, with industry input to the best extent possible, the terms "substantial equity" and "sufficiently pre-leased" in order to clarify the definition of HVCRE.

In addition, we urge the Committee to conduct a study on the impact of the New Accord to:

a) Determine the concentration of CMBS holdings across individual banks and the real estate industry that could be affected by the New Accord;

b) Determine expected capital changes for CRE portfolios and CMBS holdings under the New Accord; and

c) Assess the impact of expected capital changes on individual bank and industry credit prices, funding activity and competitive activity.

We believe that only through such analysis can we ensure that the New Accord is functioning appropriately. The Roundtable strongly urges the Committee to conduct this additional research on the impact of the proposed accord on the global economy and affected industries and to provide opportunity for continued industry comment on additional changes to the accord necessary to mitigate the sectoral and macroeconomic concerns.

We trust the Committee may find our few 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,

Jeffrey D. DeBoer
President and Chief Operating Officer

cc:

Board of Governors
The Federal Reserve System
Basel Capital Proposal
Mail Stop 179
21st and C Streets, NW
Washington, DC 20551

Basel Capital Proposal
Office of the Comptroller of the Currency
Mail Stop 3-6
250 E Street, SW
Washington, DC 20219

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

The Honorable Michael G. Oxley
Chairman, Committee on Financial Services
United States House of Representatives
2157 Rayburn House Office Building
Washington, DC, 20515

The Honorable Richard C. Shelby
Chairman, Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510