The Real Estate Roundtable

March 25, 2003

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

Re: Request for Comments 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 New Basel Capital Accord ("New Accord"), issued for comment on January 16, 2001.

The New Accord could have a significant negative impact on the flow of credit to the commercial real estate industry and, thereby, diminish its overall liquidity and valuation. Both these potential results would compound the already weakened US and global economies. As such, we appreciate the opportunity to provide the Committee, as well as the US banking regulatory agencies, with our serious concerns about the New Accord.

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.

Unintended Consequences of the New Accord

The Real Estate Roundtable ("the Roundtable") supports the Committee's efforts to develop a more balanced and consistent conceptual risk capital framework. By more closely aligning regulatory capital with economic capital, the New Accord could 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 serious 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 could generate.

The Roundtable generally supports the US regulatory agencies' proposed ratings-based, multi-level approach that would directly link capital requirements and levels to the rating assigned to a particular asset securitization position. We believe that such an approach, with certain refinements, could provide banking organizations with an improved, more efficient regulatory capital framework. It could also afford banks far greater flexibility than they now enjoy in managing their credit exposure through various investments, credit enhancement activities and securitization strategies.

However, the New Accord deviates from its variable risk-weighting approach when it assigns a 100 percent risk-weight for commercial mortgages regardless of the credit of the obligor. This is especially unwarranted when one considers that CMBS that are collateralized by these same commercial mortgages are able to achieve risk weights of as low as 20% for the highest quality investment grade offerings. These unreasonably high risk weights for both commercial and residential loans could undermine bank lending to the real estate sector – thereby diminishing the availability of real estate credit. In short, the proposed capital increases, coupled with rules that are not directly linked to economic risks, could have significant negative consequences for real estate, and further weaken an already frail economy.

Economic Cycles and Real Estate

While the income-producing or "commercial" real estate ("CRE") industry has a history of volatility due to supply and demand imbalances caused by economic cycles, there is general agreement by industry professionals and analysts that future real estate cycles are likely to be less severe in magnitude than the last major economic cycle. This conclusion is primarily attributable to the following developments:

- 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. 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 US 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 banks remain the single largest source of credit for CRE (approximately 42 percent of the total market in 2001), bank underwriting standards have improved since the last 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.

Financial service company regulators and analysts generally acknowledge that, to date, there has been little increase in the level of non-current CRE loans on the books of commercial banks. In addition, improved market information, greater public market scrutiny and more solid underwriting have clearly contributed to the integrity of current bank CRE portfolios. However, CRE credit problems could begin to rise over time if a strong economic recovery fails to materialize in 2003.

The Roundtable strongly urges the Committee to conduct additional research on the impact of the proposed accord on the global economy and affected industries. We also encourage you to provide additional opportunities for affected industries to comment on appropriate changes to the accord essential 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,

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President and Chief Operating Officer

JDD/mmr

cc: Board of Governors of the Federal Reserve System
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