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MEMORANDUM

December 8, 2006

To Our Clients and Friends

Re: Guidance Regarding Commercial Real Estate Lending

The Federal Reserve Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation have issued interagency guidance regarding concentrations in commercial real estate lending. The guidance applies to banks and bank holding companies. The Office of Thrift Supervision has issued separate guidance applicable to savings associations.

BACKGROUND

The banking agencies have observed that commercial real estate lending has risen significantly over the past several years. The agencies are concerned that lending at such levels could create safety and soundness concerns in the event of an economic downturn. The guidance reminds institutions that there are substantial risks posed by commercial real estate concentrations that institutions are expected to adequately address. The Agencies' existing capital adequacy guidelines note that an institution should hold capital commensurate with the level and nature of the risks to which it is exposed. Accordingly, institutions with commercial real estate concentrations are reminded that their capital levels should be commensurate with the risk profile of their CRE portfolios.

Institutions are required to address the following key elements in establishing a risk management framework that identifies, monitors and controls concentration risk:

- Board and management oversight
- Portfolio management
- Management information systems
- Market analysis
- Credit underwriting standards
- Portfolio stress testing and sensitivity analysis
- Credit risk review function

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The Agencies stated that they will use the following criteria as a preliminary step to identify institutions that may have commercial real estate concentration risk:

- Total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or
- Total commercial real estate loans represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50 percent or more during the prior 36 months.

OTS GUIDANCE

The guidance issued by the OTS is similar to that adopted by the other agencies. However, the OTS determined not to adopt numerical thresholds. Rather, the OTS provided that institutions that had recently experienced rapid growth in commercial real estate lending or that have a notable exposure to a specific type of commercial real estate risk may be subject to closer review.

The Agencies' notices can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.