ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES, AND INCREASING JOB GROWTH

HEARING

BEFORE THE

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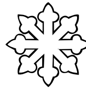

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ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES, AND INCREASING JOB GROWTH

Thursday, July 29, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Watt, Moore of Kansas, Hinojosa, Clay, McCarthy of New York, Scott, Green, Cleaver, Perlmutter, Donnelly, Minnick, Adler, Kosmas, Himes, Maffei; Bachus, Biggert, Miller of California, Hensarling, Neugebauer, Posey, Jenkins, Paulsen, and Lance.

Also present: Representative Shuler.

The CHAIRMAN. The hearing will come to order.

And I am going to first recognize the gentleman from Idaho, Mr. Minnick, who was the major force in bringing this issue to our attention, along with others on both sides of the aisle. But he has made it a particular point and is one of those who was most responsible for our decision to have this hearing.

So the gentleman from Idaho is now recognized for 3 minutes.

Mr. MINNICK. Thank you, Mr. Chairman.

Mr. Chairman, and Ranking Member Baucus, thank you for calling this hearing today on the Commercial Real Estate Stabilization Act that I introduced with Heath Shuler, Suzanne Kosmas, Mike Simpson, Martin Heinrich, and Steve LaTourette. This is truly a bipartisan piece of legislation to address a looming national crisis.

According to the Congressional Oversight Panel, the value of the Nation's commercial real estate has declined by more than 40 percent. In 2007, it was worth $5.5 trillion and supported $3.3 trillion in debt. Today, it is worth only about $3 trillion and will only support about $2 trillion in debt.

Most of the commercial real estate lenders on the smaller projects in Main Street America are our local community banks. As those $3.3 trillion in loans come due, either the already overextended borrowers must come up with new equity or the banks renewing the loans must write them down. Doing so impairs the banks' capital and ability to continue doing business.

If this plays out in the free market, the Oversight Panel estimates that as many as a quarter of America's 8,000 smaller banks are at risk. This process is being accelerated by bank regulators who are demanding our smaller banks reduce their exposure to the falling commercial real estate market by reducing their commercial real estate loans from an average of over 3 times their capital to one-third that level.

In my State, fully a third of my banks are already under Federal supervision, and many more fear they will be, come the next bank examination. As a result, small business can't borrow and, without credit, can't create the new jobs our economy so desperately needs to continue the economic recovery.

This bipartisan bill will allow our smaller banks to sell their performing loans—subject to the tough new risk-retention rules we have just enacted—to larger money center financial institutions, which will aggregate them into larger, institutional-sized packages of loans and get them rated as investment-grade by rating agencies, who now must stand behind their ratings and can be sued if they prove negligent.

These larger financial institutions will then have these packages guaranteed by the Treasury, making them marketable to pension funds and other institutional buyers. This process will jump-start the commercial mortgage bond market, which used to supply two-thirds of the capital to the commercial real estate market but has not existed at all for smaller properties since the market collapsed 2 years ago.

This will allow our smaller community banks to clear their portfolios of illiquid but performing commercial real estate loans and reduce their inventories to levels demanded by their regulators at fair market, not sacrificed, prices. This will stabilize their balance sheets so they can both survive and again begin lending to builders, developers, and small businesses, who will create the new jobs required for our economy to recover.

The program will be administered by a board consisting of the Treasury Secretary, the Federal Reserve Chairman, the SEC Chairman, the FDIC Chairman, the FHA Director, and four industry experts appointed by the President.

Because the assets insured will be investment-grade, and the Treasury will be paid a hefty 2 percent insurance fee, the program will make money for the Treasury and will only be required until the private market regains the confidence it needs to create and market these instruments without needing a Federal guarantee.

It will expire on its own accord in 3 years, and the Secretary of the Treasury will have the authority to terminate it sooner if he determines that the commercial bond market is comfortably reestablished. All profits earned from the program are required to be used to reduce the deficit.

Thank you, Mr. Chairman. I look forward to hearing from our panel of experts.

The CHAIRMAN. I would note that the gentleman used 3 minutes and 50 seconds. That will leave us with 5 minutes and 10 seconds.

And I now recognize the gentleman from Alabama for 2 minutes.

First, let me ask unanimous consent that we have one of the co-sponsors, the gentleman from North Carolina, Mr. Shuler, join us today. Is there any objection?

Hearing none, the gentleman is welcomed.

And the gentleman from—

Mr. BACHUS. Mr. Perlmutter objected, I think.

Mr. PERLMUTTER. No, I withdrew it.

The CHAIRMAN. I didn't hear him. He did it visually.

Mr. BACHUS. If he won't mention Tennessee Volunteer football, I will go along with it.

Mr. SHULER. After last season, no.

The CHAIRMAN. The gentleman from Alabama is now recognized for 2 minutes.

Mr. BACHUS. Thank you, Mr. Chairman. And I thank you for holding the hearing on issues facing the commercial real estate market.

On an almost daily basis, I am told that financial institutions, at the urgings of regulators, are making additional capital demands on their borrowers with commercial real estate loans, creating a vicious cycle of distress sales, lower appraisals, and depreciation for neighboring properties. Many of us are particularly concerned about the financial challenges just ahead, where somewhere between $200 billion and $500 billion in commercial real estate loans mature in the next 12 to 15 months.

These are aggravated in Alabama and the Gulf Coast by economic fallout from the BP oil spill. There we are seeing a preview of what we will soon experience throughout the country, or may experience: a cascade effect of less tourism; a diminished capacity to repay loans; lower appraisals, which depress property values; fewer real estate sales; and overall lower revenues for businesses and struggling communities.

In Alabama and other Gulf Coast States, the financial impact has rippled from the shoreline throughout our entire State due to less tax revenue. Aggravating that situation are unfilled promises by BP to compensate for the losses, which is particularly upsetting when the citizens of Alabama see BP's public relations campaign on TV claiming to expedite the claims, although their claims have not been processed.

It is my pleasure to invite Gulf Shores Mayor Robert Craft to testify today to inform us about the additional challenges facing communities and States dealing with what can only be termed an environmental and economic catastrophe. He is, in every sense of the word, an eyewitness to what is going on.

With regard to the broader commercial real estate market, what is happening along the Gulf is indicative of what could happen across the country if credit is not made available to the marketplace. Once these loans come due, the losses to the FDIC Insurance Fund could be significant.

One of the proposals we are hearing is a new $25 billion fund for commercial real estate with the Treasury Department with a 10-year full faith and credit. We need to look long and hard at this, about whether we may be creating even more risk from the private sector to the taxpayer.

A worthwhile strategy, in my view—and I will close with this—is Mr. Garrett's legislation, the U.S. Covered Bonds Act, on which Congressman Kanjorski and I joined him as original cosponsors. This should move to the House Floor as soon as possible. And I think it would be a valuable source of liquidity to the commercial real estate market.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from Florida, Ms. Kosmas, for 2 minutes.

Ms. KOSMAS. Thank you, Mr. Chairman. And thank you to those who are here for the hearing. I just want to make a few quick comments on this.

As a small business owner myself for most of my life, I agree with the comment that community banks are the lifeblood of our communities and that we have to ensure their continued viability. Many of us have recognized for a long time and have made comments in this committee and elsewhere about the need to ensure that our commercial real estate markets remain viable so that businesses can function.

Many businesses, both small and medium-sized, in my district and elsewhere, cannot access new loans, and banks are often forced to cut off their existing lines of credit. This, of course, causes these businesses to lay off employees and threatens their ability to continue to operate.

This dilemma is compounded by the fact that many community banks are unable to find financial stability or are unable to deal with the often arbitrary requirements regulators place on them. As a result, the communities, both the businesses and families within those communities that have been served for years, are under threat of no longer having available to them the vital credit and other services that they need from institutions with whom they have built strong, long-term relationships.

I think this bill is a very important piece of legislation. It is a commonsense, bipartisan solution that smartly facilities the development of private commercial credit markets and incentivizes the free market to take action here. If we do not act fast, we risk missing a window of opportunity for properly dealing with the trillions of dollars in debt set to come due over the next few years.

The price to pay for inaction will be significantly increased in States like Florida. Florida's unemployment rate continues to be the Nation's fifth highest. In addition, the recent oil spill could easily cause a double-dip in Florida's economy. With Florida's main economic drivers being tourism and growth, we recognize that the oil spill has the potential to exacerbate the difficult economic situation that already exists there.

I really urge my colleagues to look closely at this and to support this very fine piece of legislation.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman. I am pleased that we are having yet another hearing on commercial real estate.

At my request, the Oversight and Investigations Subcommittee held a hearing in Chicago in May on this topic. Chicago is home to key leaders in all aspects of commercial real estate, also called

CRE, including acquisitions, appraisals, mortgage lending, and securitization, to name a few.

During our field hearing, we learned that the CRE industry faced many obstacles to recovery, including property devaluation and illiquidity in the securities market. We also discussed the difficulty some banks, especially smaller banks, have with concentrations of riskier or specific kinds of CRE loans.

Several regulators testified, and it became apparent that a few regulators clearly dropped the ball after the CRE crisis that occurred during the 1990's. Some regulators failed to issue regulations in a timely fashion to address concentrations in CRE loans at financial institutions. And when these same regulators finally issued regulations, these regulations were clearly not enforced, as was discussed in many material loss reviews of failed banks.

There are many ideas floating around about how to address the problems in the market. However, I am very concerned with any proposals that would create a new taxpayer-backed program instead of addressing some of the fundamental problems with CRE that have been mentioned.

Finally, I believe that one of the most important things Congress can do to jump-start the CRE market is to move legislation that will provide incentives for businesses, especially small businesses, to create jobs.

This June, unemployment in Illinois was 10.4 percent, and it remains above the national average of 9.5 percent. With businesses downsizing or shutting their doors, workers being laid off, taxes increasing, and regulatory and market uncertainty, we can anticipate additional residential foreclosures, followed by the commercial building vacancies. Job creation should be the number-one priority for this Congress.

With that, I look forward to hearing from today's witnesses.

The CHAIRMAN. The gentleman from California, Mr. Miller, is recognized for 2 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

I want to commend Mr. Minnick for trying to address this issue, but there are some concerns with the way the bill is proposed.

One concern in high-cost areas, for example Mr. Frank's district or mine, putting a $10 million arbitrary cap on that would tend to focus the amount more on commercial strip centers, small commercial buildings. Those projects are basically more sensitive to the economy than the larger projects are.

But a problem I have that I don't think this is going to address is something I brought up 3 years ago. There is not a shortage of qualified borrowers, and there is not a shortage of qualified projects. The problem is that lenders are put in a situation by mark-to-market requirements that, if you take a loan and it is devalued 45 to 50 percent, this bill does not address that.

So if we are talking about a conforming loan, a loan that basically is performing, that is not the problem. The problem is the loans that you could say are not performing because of ST requirements or mark-to-market that take a loan where the lender is current with the borrower, yet when it comes time to refinance the loan, the loan is upside down based on the SEC requirements or mark-to-market. That will not change this.

And unless we are willing to address that issue, you are not going to take a loan that you can say is performing, because if it is performing, the small lender has no problem with it, but taking that loan and giving it to a larger lender and say the government is going to back that loan, we are going to turn it into a commercial mortgage-backed security, you can't do that if the loan is not performing and it is not meeting current market standards.

So I applaud you for this effort because we need to address it, but it does not address the problem we are going to face out there. I agree, there is no way in the world we should put the taxpayers at risk. But you are not going to have the government come in and guarantee a loan that is not performing to begin with. The loans that are going to be transferred or are going to want to be transferred are the ones that are not performing, because if a loan is performing, the lender has no problem with the loan.

So why would a lender want to get rid of a performing loan that meets the requirements, when the regulators are coming in and saying, "Get rid of the loans that do not meet the requirement."

And I could go 20 minutes on this, Mr. Chairman—

The CHAIRMAN. No, you can't.

Mr. MILLER OF CALIFORNIA. —but I applaud you. I know you will not let me, I know you will not lend me the time, but I would love to work on this issue.

The CHAIRMAN. The gentleman from Colorado is recognized for 2 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

And, Mr. Miller, you and I should sit down and work on this together.

About 4 weeks ago, we passed a bill, the Small Business Lending Act, and attached to that bill was a bill that I proposed, along with Mr. Mike Coffman, a Republican from Colorado, which did very much what Mr. Miller was talking about. You took a capital loss on real estate but then amortized it out over 6 years, up to 10 years, if small business loans were being made by that particular bank.

A similar type of approach was taken back in the 1980's with agricultural banks and other banks. Mr. Bill Isaac addresses it, calls it a net worth certificate that was used back in the 1980's. So that independent, small, community, regional banks could weather the storm. And we have had a heck of a storm over the course of the last 2 years.

One of our panelists, Mr. Ernie Panasci—from Denver, Colorado, a prominent financial attorney in Colorado and in the Denver area—helped us draft the amendment that has passed on to the Senate and is part of the Small Business Lending Act. He will testify today about the difficulties that a number of Colorado banks and borrowers are having because of the drop in commercial real estate prices.

And it is my pleasure to introduce him now, because I may be gone when he finally gets to testify, that he is here to speak on behalf of bankers and the real estate community in Colorado on this very important subject.

With that, Mr. Chairman, I would yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling, for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

I think we all know that there are serious problems in our commercial real estate market. Many fear that the worst is yet to come over the next couple of years. This may be true. On the other hand, I think I have noted that REITs are up 7.7 percent this year, while our major equity indexes are pretty well flat. I read recently that JPMorgan, Goldman, and Citi are at least seemingly returning to the securitization market. So, how bad things are, relatively speaking, I think to some extent it is hard to tell.

I do know that, although this bill is well-intended—I took very careful note of what the gentleman from California says. I appreciate the experience and perspective that he brings. And, indeed, I think the application of mark-to-market, even today, is a significant part of our challenge. But I fear, at the end of the day, that we are looking at one more taxpayer backstop, perhaps one more taxpayer bailout, that I am not sure—in fact, I feel quite dubious—that it is going to be worth the cost.

I know recently the Special Inspector General for the TARP reported, "The current outstanding balance of overall Federal support for the Nation's financial system has actually increased more than 23 percent over the past year, from approximately $3 trillion to $3.7 trillion." At what point do we say, enough is enough?

There are many people who benefited on the upside of the run-up of the commercial real estate market. They enjoyed the upside, and now they want the taxpayer to be exposed to the downside.

I think ultimately, we are going to have to concentrate on the demand side of this equation, and that is getting the economy moving. And, again, I fear that the greater problem is not lack of capital, it is lack of confidence from the actions of this President and this Congress. And until that changes, we are not going to solve the market problems.

The CHAIRMAN. The gentleman's time has expired.

Next, I will go to the gentleman from Texas, Mr. Neugebauer, because our last speaker is a non-member and we take members first. The gentleman from Texas, Mr. Neugebauer, for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I appreciate you having this hearing.

Obviously, all of us know that the commercial real estate borrowers are looking to refinance some of their loans, but they are faced with lower property values, higher vacancy rates, and there are reasonable questions about the capacity of the lenders to be able to do that.

I appreciate the gentleman from Colorado and others who work on this issue. But the problem here is that everybody's answer to freeing up the credit markets again is putting the taxpayers on the hook for some of the risk.

These markets functioned before without the taxpayers, but now, for some reason, we, with this big marriage of the Federal Government and all these markets—and many of us voted against that because we knew it was going to be a rocky marriage to begin with, but what I have been saying for a number of months is that the divorce is going to be worse than the marriage. And that is

weaning the private markets from saying, "You know what? We are not quite sure we want to take that risk, but we might be willing to take it if the taxpayers would pick up part of the tab."

We can't build a long-term future for this country on the backs of the taxpayers. The taxpayers, quite honestly, are facing their own challenges right now. And so what we really need to do is get rid of all of this uncertainty that we have created in Congress about the potential implications of regulations and taxation and get the government out of the way and let the free markets work.

Free markets, when allowed to function properly, aren't kind, but they are very efficient. The problem is that we have delayed the efficiency in the market by all of this intervention. And what it is really time to finally do is let the free markets work, and they will work through this.

But very few times when you put the taxpayer on the hook are we going to be able to unhook the taxpayer. And the taxpayers back home in Texas are tired of being hooked up.

With that, I yield back my time.

The CHAIRMAN. The gentleman from North Carolina.

I am sorry, but we don't have back-and-forth during opening statements.

Mr. PERLMUTTER. I just wanted to have something admitted for the record.

The CHAIRMAN. Oh, yes.

Mr. PERLMUTTER. An article that Steve Kagen, Ron Klein, and I wrote for Forbes magazine, dated July 19, 2010.

The CHAIRMAN. Without objection, it is so ordered.

I also have been asked by the National Association of Home Builders to put their statement in the record. I will just read the operative paragraph:

"NAHB urges Congress to direct financial institution regulators to encourage lenders to work with residential construction borrowers who have loans in good standing by providing flexibility on reappraisals, loan modifications, and perhaps forbearance. Solutions could include allowing institutions to continue making and holding sound acquisition, development, and construction loans even if they are above the loan-to-capital thresholds and to permit institutions to write down troubled loans over an extended period up to 10 years."

If there is no objection, I will put that in the record.

And the final statement comes from the—

Mr. MINNICK. Mr. Chairman?

The CHAIRMAN. Yes.

Mr. MINNICK. I would ask your permission to enter into the record the text of an interview that I gave on this topic that appears in today's New York Times.

The CHAIRMAN. Without objection, it is so ordered.

Mr. BACHUS. Mr. Chairman, I ask for unanimous consent that anyone who—

The CHAIRMAN. Right, we have general leave that anything that members want put in the record can be put in. The gentleman is correct. There is no objection.

And finally, without objection, we will hear from our non-member who is a cosponsor of the legislation, the gentleman from North Carolina, Mr. Shuler.

Mr. SHULER. Thank you, Mr. Chairman.

Chairman Frank, Ranking Member Bachus, and members of the committee, I appreciate the opportunity to participate in this hearing to discuss the Commercial Real Estate Stabilization Act with you. I am proud to introduce this bill with Walt Minnick and Suzanne Kosmas because I truly believe that commercial real estate and failing community banks are problems for my district and the rest of the country.

This problem starts with commercial real estate but doesn't end there. In rural America, the concerns about commercial real estate are pressing. Depressed commercial real estate values are also affecting the big picture. What starts with commercial real estate stretches from local community banks to our small businesses, decreasing the amount of job opportunities and stunting job growth. If community banks can't lend, and they can't refinance the loans on their books, they will be seized by the FDIC. Once that happens, small business lending and job growth are doomed.

We are all just beginning to understand the scope of this large, multi-trillion-dollar problem. It is complicated, and until today, most people decided to kick the can down the road and to ignore the problem. Congressman Minnick and others, along with our staff, have held over 300 meetings over the last year with all affected parties and only come to the conclusion that something has to be done, and done fast.

I think this bill is an effective, practical way to start addressing the lack of credit and liquidity in the commercial real estate market, which, in return, will start giving some community banks and commercial real estate developers around the country a fighting chance.

At the rate that we are going today, if we don't get this bill moving or come up with something similar to address this problem, we will have a massive problem for our Nation's real estate and business world. CRESA affects Main Street America and everyday small businesses and entrepreneurs. I look forward to working with you through this piece of legislation.

I yield back the balance of my time.

The CHAIRMAN. We will now begin the hearing. We will start with Mr. Thomas Gronstal, who is the superintendent of the Iowa Division of Banking. He is here on behalf of our frequent collaborator, with whom we enjoy working, the Conference of State Bank Supervisors.

I would note that, in the financial reform bill, where there are entities set up consisting of groups of regulators, at the initiative of the House, the Conference of State Bank Supervisors is a participant. And we welcome the ability to work with the CSBS. Thank you.

Mr. Gronstal, go ahead.

STATEMENT OF THOMAS B. GRONSTAL, IOWA SUPERINTENDENT OF BANKING, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. GRONSTAL. Thank you. Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the committee. As was stated, I am Tom Gronstal, superintendent of banking for the State of Iowa, and chairman of the Conference of State Bank Supervisors.

Thank you for inviting me here today. We appreciate the time that the committee and that Representative Minnick, in particular, have devoted to exploring the means for stabilizing the commercial real estate market and overcoming the challenges that community banks continue to face in serving this market.

The current economic environment has created a great deal of uncertainty in the commercial real estate market. This uncertainty poses challenges for businesses, investors, and banks. Investors and businesses are likely to restrain capital investments and plans for expansion, and lenders hesitate to extend credit as they struggle to ensure collateral protection and the ability to repay.

These issues are having a significant impact on the commercial real estate market, affecting the performance of existing loans, valuations on bank balance sheets, and, ultimately, the availability of credit.

In my home State of Iowa, the number of banks with considerable commercial real estate concentrations has declined over the past 3 years. Public demand for commercial real estate loans has greatly diminished, and there is very little new development occurring in the State. This has caused unemployment in the construction sectors to rise notably over the past 2 or 3 years.

Most of my colleagues around the country are seeing many aspects of the commercial real estate market stabilizing, but general demand for commercial real estate loans continues to lag, and banks' interest in funding new commercial real estate loans is still low.

As regulators and policymakers, we must recognize that any economic recovery will be uneven. In some regions of the Nation, portions of the banking industry and financial markets continue to face significant challenges, even as other areas are showing signs of recovery.

Given where we are in the current economic cycle, we believe that Congress can play an important role the commercial real estate market by providing a Federal guarantee for prudently underwritten loans. Therefore, CSBS supports the objectives of Representative Minnick's Commercial Real Estate Stabilization Act, its focus on small and mid-size institutions, and its approach of leveraging a government guarantee to incent private lending and investment activity.

Federal guarantees have been effectively used to support bank lending to small businesses and farmers, and CRESA can be structured as a measured risk to support private investment and lending to further public policy and economic objectives.

In addition, CRESA contemplates conservative lending by community banks and other institutions with the expertise and experience to engage in successful commercial real estate lending. The

program's use of a government guarantee to attract and encourage private market activity increases the likelihood of broader market benefits beyond the individual transactions. Ultimately, implementation of CRESA could provide fuel for market stability and remove uncertainty among market participants.

In terms of the program's structure and oversight, we propose that State bank regulators should be represented on the program's oversight board. Giving CRESA's stated focus on smaller institutions, State bank regulators, as prudential regulators of the vast majority of community banks and because of our knowledge of local economies, should be a part of CRESA oversight.

CSBS remains a fierce supporter of the Nation's dual banking system, which supports community banking. We commend Congress for reaffirming the dual banking system in the Dodd-Frank Wall Street Reform and Consumer Protection Act. And we believe Representative Minnick's proposal is also an affirmation of the dual banking system and the vital role community banks play in our national economy.

Ultimately, our Nation's leaders must seek to create a holistic approach to stabilize all banking industry participants. Government efforts must be undertaken, with the stated objectives of stabilizing not only the national economy but local economies as well. Only through preserving a diverse financial industry and stimulating local economies will we ultimately enjoy a comprehensive and sustainable economic recovery.

I appreciate the opportunity to testify today, and I look forward to answering any questions you may have. Thank you.

[The prepared statement of Mr. Gronstal can be found on page 54 of the appendix.]

Mr. MINNICK. [presiding] Thank you, Mr. Gronstal.

The Chair asks the gentleman from Alabama to introduce our next witness.

Mr. BACHUS. Thank you.

It is my pleasure to introduce Mayor Robert Craft of Gulf Shores, Alabama. He has not only been a dynamic public figure, but he is also a highly successful businessman and farmer. He has a 1,200-acre turf farm and sells to a lot of landscapers and contractors. He also developed and is the owner of a residential planned community, which is actually nine residential—I guess you would call them villages. It has two Arnold Palmer golf courses on it, a Courtyard by Marriott, and also a condominium complex.

So he has seen it, not only as mayor, but also as a businessman dealing with banks. He has seen his community, over the past 30 years that he has been a resident, mushroom and prosper despite hurricanes. But what he is facing today is, I think, the most challenging time that Gulf Shores has faced in its long and prosperous history: a combination of the tough economics and then aggravated tremendously by the BP oil spill. So he is truly an eyewitness to what is happening, as I said in my opening statement. And I look forward to his testimony.

I know I was talking to—Congressman Shuler and I were at breakfast together, and he was talking about some of the challenges facing North Carolina. And I think because of the oil spill, we are probably just 2 or 3 months ahead of the curve, but I know

you are experiencing a lot of the same frustrations that the mayor discussed with me yesterday, and we have heard it here, and that is this vicious cycle of banks because the regulators are pushing them into taking action and calling loans or asking for more collateral, had distress sales. I know your son is—

Mr. WATT. Mr. Chairman, could we get on with the hearing instead of listening to our colleague?

Mr. MINNICK. Yes, I guess we can. We have been doing this since before you got here. All the members—

Mr. WATT. But we are past the opening-statement point. We are trying to listen to the witnesses.

Mr. MINNICK. You may proceed, Mr. Bachus.

Mr. BACHUS. Thank you.

Let me just close by saying, I appreciate you being here, Mayor Craft.

Mr. CRAFT. Thank you, sir.

Mr. MINNICK. Mayor Craft?

STATEMENT OF THE HONORABLE ROBERT CRAFT, MAYOR, GULF SHORES, ALABAMA

Mr. CRAFT. Chairman Frank, Ranking Member Bachus, and members of the committee, first let me state again how much the Gulf Coast residents along the Gulf of Mexico appreciate your interest in our region in the aftermath of this BP oil spill.

This hearing concerns possible legislative efforts to address the ongoing difficulties in the commercial real estate market. Of course, these difficulties have had a very significant impact along the Gulf Coast of America. Property values have fallen dramatically in our communities, as they have fallen elsewhere. Banks that provided credit to our community have been significantly damaged. Over the past several years, these banks have charged off tens of millions of dollars of loans in Gulf Shores alone. Now, Federal bank regulators are requiring further write-offs based on the temporary loss of real estate value, given the uncertainties of the conditions created by the oil spill.

Once the leak is stopped and the beaches are cleaned up, tourism will return, and property values will return as well. That doesn't mean they will return to 2006 valuations, but they will certainly return to pre-spill valuations. In fact, Mr. Feinberg has stated that his BP fund claims process will not recognize any real estate claims for just this reason: Real estate values are only down temporarily.

Unfortunately, the bank regulators are aggravating the problems on the Coast by various actions they have taken. The interagency statement that these regulators issue is of no value either to the affected banks or to the residents of the Gulf Coast. The statement that urges banks to waive late fees and ATM charges are gestures of no meaning.

Our banks have had Federal examiners twice force them to write off millions of dollars in performing loans that are current simply on the basis that the underlying collateral has lost value since the oil spill. This makes no sense. It just makes recovery of the region that much more difficult, if not impossible.

Without help, Gulf Shores and Orange Beach, our neighbor to the east, would lose what has taken decades to develop across mul-

tiple generations of families. With the loss of business revenues, Gulf Shores and Orange Beach are at the risk of losing businesses needed to serve as the driver of our only island economy: tourism. Once this family business infrastructure is lost, it cannot be magically recreated.

Every business located on the island is directly affected by this disaster and has suffered loss. There are no exceptions. From the beginning of this disaster, our community has been assured that we would be made whole by BP. This has not occurred.

The financial impact of the oil disaster is devastating. Our local community of Gulf Shores and Orange Beach has approximately $1.3 billion of existing debt that is dependent on tourism revenue to service.

The Gulf Coast would urge this committee to work with Federal bank regulators to provide its banks time to work out the problems created by this spill. They need more than an interagency statement on ATM fees. Here are a few concrete examples of what is needed:

Appraisals: Bank regulators continue to insist on new appraisals even though the real estate market is so unstable as to make meaningful comparables impossible. It is essential that the bank regulators accept existing, pre-spill appraisals, not distressed valuations caused by arbitrary markdowns in the aftermath of this spill.

Bank regulators should also recognize BP and Feinberg claims as equivalent to insurance claims when those claims are corroborated with data. Thus, examiners ought to take these claims into account when assessing the repayment prospects of a loan.

There is another reality they should consider, and that is the effect this spill has had on the coastal banks' ability to raise capital. The investor community has begun to re-enter the bank capital market, even for troubled banks, but the investors have indicated that they want to let the market settle after the spill is over before investing in these area banks. The regulators should work with these banks to give them more time to raise capital.

In sum, the bank regulators need to give these banks some breathing space. And, in the long run, this will reduce the cost to the taxpayer by saving many of these banks and also allowing our area economy to recover.

Finally, these points are exactly in line with a letter that Chairman Frank and Mr. Minnick sent to the Federal bank regulators in the fall of last year. I am told by bankers that the regulators have not responded in the requested manner.

As you consider this difficult decision, please understand the consequences of adding another layer to the recovery of this region. Failure of many banks and most businesses is a certainty. Please don't underestimate the urgency that exists here. We would deeply appreciate any help you can provide in obtaining the relief mentioned here, and in Chairman Frank and Mr. Minnick's letter of October 29, 2009.

Thank you.

[The prepared statement of Mayor Craft can be found on page 38 of the appendix.]

Mr. MINNICK. Thank you, Mayor Craft.

Mr. Lancaster?

STATEMENT OF BRIAN LANCASTER, ROYAL BANK OF SCOTLAND, ON BEHALF OF THE CRE FINANCE COUNCIL

Mr. LANCASTER. Thank you, Chairman Frank, and Ranking Member Bachus. My name is Brian Lancaster, and I am here today as a board member of the Commercial Real Estate Finance Council, which represents all lenders, issuers, investors, and other services in the commercial real estate finance business.

Today, my testimony will focus on three areas: the challenges facing the $3.5 trillion market for commercial real estate finance; the unique structure of commercial mortgage-backed securities and the need to customize reforms; and suggested policies to support commercial real estate and small business.

As the lagging indicated, the $7 trillion commercial real estate market is now feeling the full impact of a prolonged recession. Today, a perfect storm exists with four interconnected challenges. We are in the midst of a severe recession. Unemployment, consumer spending, business performance, and asset values have all deteriorated and compound the CRE downturn. A severe equity gap exists in commercial real estate. Commercial properties have lost 30 percent to 50 percent of their value since 2007, and this is arguably the biggest challenge facing commercial real estate today.

More than a trillion dollars in commercial real estate loans mature in the next several years. More troubling, many of these loans will require significant borrower equity to refinance, given the decline in property values. The CMBS markets are restarting, but slowly. CMBS issuance plummeted from a peak of $240 billion in 2007, nearly 45 percent of all commercial real estate lending, to $12 billion in 2008, $2 billion in 2009, and, at $2.4 billion for the first half of this year, is just now starting to pick up.

The four key areas we believe that will provide a framework for recovery are as follows:

Increased coordination of accounting and regulatory reforms. Beyond the economic conditions, the largest impediment to a revival of the commercial mortgage-backed securities market is the uncertainty that exists due to regulatory and accounting changes. Separate from Dodd-Frank, the market already has seen several retention proposals from the regulators: new risk-based capital proposals and retroactive changes to securitization accounting under FASB 166 and 167. When taken together, these changes create tremendous uncertainty and make it difficult to make a loan, buy a bond, or develop or expand a securitization program.

Dodd-Frank includes a study on the combined impact of securitization reform proposals and credit availability. This report is important, but Congress also should promote greater coordination between regulators and accounting policymakers.

Policymakers must remember that the commercial mortgage-backed securities market is very different in several ways. CMBS borrowers are sophisticated businesses with income-producing properties. The CMBS structure typically has 100 to 200 loans that average $8 million in size. There is significant transparency; although it can be made better, it is actually quite high. At the Commercial Real Estate Finance Council, we have the Investor Report-

ing Package, which was designed by investors for investors to improve transparency. And it is the only market with first-loss investors who re-underwrite all loans prior to issuance.

Dodd-Frank rightfully ensures that retention rules are considered jointly with some specific considerations for commercial real estate loans and CMBS. We applaud Congress for these distinctions, and we urge regulators to ensure that risk retention for commercial real estate loans is implemented in such a way as to promote a recovery of the flow of credit to the real estate borrowers and sound lending practices.

Investors need certainty in regulation and confidence in other areas such as ratings and contractual agreements. Policymakers should consider ways to use securitization as an exit strategy after institutions fail, similar to the Resolution Trust Corporation's. Other items include creating a U.S. covered bond market as an additive tool, accounting relief for consolidation, and proposals to recognize losses over time.

However, the challenges facing the commercial real estate market today are beyond the scope of what any one program could or should do in attempting to provide a solution. Today, smaller financial institutions, such as small and regional banks, face the greatest strain from commercial real estate, particularly construction loans and land loans that have not been securitized. In fact, approximately 1,500 U.S. banks are at risk, according to the FDIC, due to commercial real estate exposure which is on balance sheet.

Given the commercial real estate challenges faced by small institutions and small businesses, it is logical that the small business lending fund also incorporate small commercial real estate mortgages that are income-producing. The council applauds Congressman Minnick's efforts to clarify the definition of small business lending to commercial real estate loans. If implemented properly, it could assist in recapitalizing small banks while incentivizing commercial real estate lending to small business to fuel job growth.

The council commends Representative Minnick's efforts with CRESA, and we would make the following points: Additional liquidity could be helpful, but any approach should incentivize financial institutions and borrowers to deal with the equity gap in existing loans. Encouraging securitization of such high-quality assets could maximize benefits by freeing up balance sheets and promoting additional private lending. We stress that mortgage lending for small businesses be provided by a variety of small, mid-sized, and larger banks, life insurers, and other nonbank lenders.

Thank you.

Mr. MINNICK. Thank you very much.

I neglected to mention that Mr. Lancaster is speaking on behalf of the Commercial Real Estate Finance Council. And we appreciate your cataloging the issues that face your members. Thank you for your testimony.

Mr. LANCASTER. Thank you, Representative Minnick.

Mr. MINNICK. I would now like to call on Mr. James Helsel, who is going to speak on behalf of the National Association of Realtors.

STATEMENT OF JAMES L. HELSEL, JR., 2010 TREASURER, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. HELSEL. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee. My name is Jim Helsel. I am the 2010 treasurer of the National Association of Realtors, and I thank you for the invitation to testify before you today.

I have been a Realtor for more than 35 years, specializing strictly in commercial real estate. I am president of Helsel Incorporated Realtors in Camp Hill, Pennsylvania. I am here today to testify on behalf of the 1.1 million Realtors of the National Association of Realtors.

We are in support of several resolutions to ease the commercial real estate credit crisis and to restore lending to the small business community.

First, I want to address H.R. 5816, the Commercial Real Estate Stabilization Act. We applaud its goals to help stabilize the commercial market and to clear troubled properties off the market. We are ready to work with Representative Minnick and the committee to review this proposal to see how it could help restore our industry.

Second, NAR strongly supports H.R. 3380, introduced by Representatives Kanjorski and Royce, which would raise the credit union members' business lending cap from 12.25 percent to 25 percent of total assets.

Lack of available credit remains a significant challenge for our industry right now. What is more, it is the smaller regional and community banks with large commercial real estate exposure that count for almost one-half of the entire business loans issued in the country. That has put a significant dent in the commercial and the credit availability to small business communities. In turn, this has reduced cash flow and elevated vacancies in the commercial markets.

In the past, consumers and businesses have relied on credit unions to fill the gaps when banks cannot serve them. But today, credit unions are hampered by the 12.25 percent cap that is before them. The Credit Union National Association estimates that if H.R. 3380 were signed into law, credit unions could extend up to $10 billion in additional business loans, helping create 108,000 jobs.

We strongly urge this committee to move H.R. 3380 forward.

Furthermore, we also support the Administration's proposed increase of the cap on credit union member business lending at 27.5 percent of total assets. However, we oppose the Administration's requirement that credit unions must have at least 5 years of member business lending experience in order to qualify for the higher limit. It would unfairly prevent credit unions that are well-capitalized and ready to lend to the small business community from participating.

Anecdotally, I would like to just tell you a very short story. About a year ago—I am, by the way, a very small business in central Pennsylvania—I had the opportunity and the requirement to refund and to refinance a loan I had on a small building where my business exists. That building sat on a loan that was a 20-year amortization with a 10-year balloon. At the end of 10 years, 1999, it was my obligation to refinance the loan. It was a performing asset;

it was a performing loan. We had never missed a payment. The asset was performing on its own, as well.

I went to three banks, one which held the loan and two others, all of which said, "I am sorry, Mr. Helsel. We are out of the real estate business right now." I went to a credit union. In 3 days, the credit union gave me a commitment letter subject to an appraisal.

By the way, the equity, the LTV on that loan was 20/80. I only owed 20 percent of the value of the property. I could not get a loan through a commercial bank, and I went to a credit union. So, anecdotally, it tells you—and that is typical of my business and my business climate right now.

Third, I want to address the small business lending fund legislation in SBA loans. NAR recommends that you pass H.R. 5297, the Small Business Jobs and Credit Act of 2010, which was introduced by Chairman Frank. This legislation contains lending provisions that help ensure community banks have both the incentive and the capacity to increase total loans to small businesses. We strongly urge you and encourage you and your colleagues in the Senate to pass this legislation quickly.

Many small businesses are having trouble obtaining SBA loans right now. While we applaud the SBA's decision to include real estate professionals as eligible candidates for SBA loans, we believe raising loan limits for both SBA 7(a) and 504 loans can further add relief. Raising these loan limits will open up another avenue for commercial property owners to get the credit they need. Furthermore, permitting SBA 504 loans to be used to refinance performing commercial properties will also help ease the liquidity crisis in the commercial sector.

In conclusion, NAR believes it is critical for Congress to act quickly and to get capital flowing to small businesses in the commercial real estate market. A strong commercial real estate sector is critical to millions of U.S. jobs and to helping keep our overall industry afloat, and our overall economy afloat more importantly.

Thank you for this invitation to testify before you. I am happy to answer any questions you may have. Thank you so much.

[The prepared statement of Mr. Helsel can be found on page 62 of the appendix.]

Mr. MINNICK. Thank you very much, Mr. Helsel.

Next, we will hear from Mr. Chris DiAngelo, who is a partner at Dewey & LeBoeuf, a firm that I believe has done more legal work on documentation of commercial real estate lending than any firm in the world.

Mr. DiAngelo?

STATEMENT OF CHRIS DiANGELO, PARTNER, DEWEY & LEBOEUF, LLP

Mr. DIANGELO. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee. I appreciate the opportunity to speak with you today about this piece of legislation.

As the chairman mentioned, I am a partner with the Dewey & LeBoeuf law firm in New York City. I had the structured finance group. I have worked with banks and real estate lending for about 30 years.

I would just like to make a couple points about this bit of legislation, primarily from a legal point of view, but also from a somewhat economic point of view, just having been in the industry for such a long time.

The first point I would like to make is to raise the connection between small balance commercial real estate lending and small business lending generally. In this country, most small business lending actually does take the form of commercial real estate lending. And, furthermore, another connection is the connection between small business lending and jobs. There was one study that I read recently, an SBA-related study that said, for every $650,000 worth of SBA lending, one job was created. So, again, in this country, all three of these things are tied pretty closely together: small business lending; small balance commercial real estate lending; and jobs.

The second point I would like to make is the connection between small balance commercial real estate and community banks. What happened in this country over the past, say, 20 years was the phenomenon where you had the Federal GSEs, Fannie and Freddie, basically took a large part of the residential market away from the smaller banks. You had large non-depository finance companies do the other types, the so-called subprime and alt-A mortgages. You had the larger banks also doing credit cards, other types of consumer finance, large finance companies such as Ford Credit and GMAC. There was really very little left for the community banks to do other than this type of product, the small balance commercial real estate loan.

That is not to suggest that the product is a bad product or that the loans were bad. It is just pointing out that—we read so many reports today about the concentration of commercial real estate at these smaller banks, and we should understand how that happened.

The third point I would like to make relates to the issue of what happens if we don't address this problem. We actually see it happening pretty much every Friday when the FDIC sends out its weekly e-mails about the closings of banks.

And I want to make an important point about that, because I understand the reluctance for Congress and the government to embark on another Federal program. But I do want to point out that, right now, these problems of the commercial real estate lending and the community banks simply rolls to the FDIC. Again, it is not the FDIC's fault; the FDIC does not have the authority to deal with anything other than receivership estates.

So it seems to me, at least in looking at this legislation and comparing it to the authority of other Federal agencies, that by letting these problems roll into bank receiverships, we are probably maximizing the cost to the government, rather than trying to take this particular narrow problem and—I don't want to say nip it in the bud, because the bud may have already passed—but at least get it a little earlier in the process before it rolls into a receivership estate.

This problem also has been remarked on by a number of commentators, including Professor Warren's committee, which dedicated its February report to commercial real estate. This problem

of commercial real estate lending has been unusually sticky, and the various programs, to date, have just not been able to address it thoroughly.

This particular bit of legislation, I have reviewed quite carefully, and it seems to be very similar in one regard, although in different operation, to the TALF program, which was used to jump-start the securitization markets generally, although it had difficulty cracking the commercial real estate nut. By similar to TALF, I mean that it was a program that was rolled out by the Federal Government and quickly became unnecessary. It was designed to quickly become unnecessary. And the private market has taken asset-backed securities, by and large, over from the TALF program.

There are two quick points I want to make. Covered bonds, I understand that is moving ahead, and I think that is a great idea. The one observation I would make about covered bonds is it will very likely be a large bank program, and it will be very difficult to get these smaller banks and these types of loans into that program.

The second thing I would like to mention in passing is the mark-to-market observation. That is a very difficult problem. And I note that this legislation does not try to solve that problem, but rather it asks the regulators to try to solve that problem. It is a very difficult problem to address through legislation.

Anyway, thank you for your time, and I look forward to working with you and answering any questions.

[The prepared statement of Mr. DiAngelo can be found on page 48 of the appendix.]

Mr. MINNICK. Thank you, Mr. DiAngelo.

Next, we have Mr. Todd Lindsey. Mr. Lindsey has a 20-year background, I understand, in the early stages of the CMBS market and has as much experience as anyone in the room in the smaller segment of the market which this bill intends to address.

Mr. Lindsey?

STATEMENT OF TODD LINDSEY, PARTNER, US CAPITAL

Mr. LINDSEY. Thank you, Mr. Chairman, for the opportunity to testify today.

Over the last 15 years, our credit markets have become increasingly reliant on and structured around securitization. Leading industry experts and government officials, including Secretary Geithner and Chairman Bernanke, have stated that a functioning securitization market is a vital part of our credit system and our economic recovery.

Over the last 24 months, much has been done by government and private industry to stabilize the credit markets, including, as Chris mentioned, parts of the securitization market. The residential real estate, consumer credit, and corporate credit markets have stabilized, in large part because of successful government programs targeted at those particular markets. The commercial real estate market has been left behind and now poses very significant risks to the credit system and our economic recovery.

As Congressman Minnick stated, in 2007, the value of all commercial real estate was approximately $5.5 trillion. According to many research reports, values have declined by 40 percent or more

from those highs. This decline has destroyed over $2 trillion of equity in the commercial real estate markets. Further declines will create greater losses, and a majority of those losses will be absorbed by the banking system and, ultimately, the taxpayers.

The simplified graph that I have included in my testimony that I think you all have a copy of shows the significant risks that are created by a further devaluation of commercial real estate. As you can see in that graph, if you take a look at it, losses between $300 billion and $1.8 trillion are possible. It is important to understand that our entire banking system is capitalized between $1.2 trillion and $1.4 trillion. Real estate losses of the magnitude demonstrated in this graph will have a catastrophic effect on our credit system and our economy.

It should also be pointed out that many commercial real estate transactions are reflecting reductions of value of 70 percent or greater. This is the free market fixing the problem. The lack of a functioning credit market will continue to be a major cause of further declines.

In 2007, the commercial real estate securitization market provided $240 billion of funding to the commercial real estate sector. Since that time, the commercial securitization markets have been shut down. With economic regulatory and accounting risk clouding the market, the future of securitization is unclear.

In short, without some sort of government assistance, the securitization markets are not likely to provide any significant credit to the commercial real estate market. Because commercial real estate loans generally do not fully amortize over their loan term, the Nation's stock of commercial real estate loans is refinanced on a regular basis. It is estimated that $1.3 trillion of loans will reach maturity in the next 36 months.

A majority of the smaller balance commercial real estate loans are on the balance sheets of our Nation's community banks. But because of both capital and regulatory constraints, many banks are not in a position to make new loans or refinance their existing loans.

The bill we are discussing today is designed to jump-start the private commercial mortgage-backed securities market. The CMBS market is well known by market participants and has demonstrated the ability to facilitate the funding of large numbers of loans.

The bill directs the Treasury to guarantee bonds, backed by newly originated commercial loans, and the taxpayer will be protected in the following ways:

One, a large guarantee fee will be paid to the Treasury. This fee will be structured to offset any costs or losses of the program and hopefully, and I truly believe, generate very substantial profits to the taxpayers.

Only newly underwritten loans, underwritten in accordance with guidelines developed by industry experts, will be included in the program.

All properties will be reappraised at today's market valuations. Making loans at a low point in the real estate cycle has historically been very safe.

This program is not a silver bullet, and it is not a bailout for financial institutions or real estate developers. To the extent individuals or institutions have made poor decisions, they will suffer the consequences of their actions. The bill simply supports the extension of reasonable credit to the commercial real estate sector.

I look forward to any questions you may have on this program or the market in general. And thank you very much for your time and attention to this matter.

[The prepared statement of Mr. Lindsey can be found on page 71 of the appendix.]

Mr. MINNICK. Thank you very much, Mr. Lindsey.

I would like to now call on the gentleman from Connecticut, Mr. Himes, to introduce our next witness.

Mr. HIMES. Thank you, Mr. Chairman.

And it is a delight to introduce to the committee Mr. Jonathan Daniel from Stamford, Connecticut, a constituent, and principal and founder of Silo Financial Corporation, which provides a broad range of specialty capital—bridge mortgages, mezzanine loans, and other financing—in the commercial real estate market.

Mr. Daniel has been in my office on a number of occasions talking about an innovative potential solution to the challenges that we are talking about today using and leveraging the successful SBIC program. And I look forward to having the opportunity to share his ideas with the committee.

Thank you.

STATEMENT OF JONATHAN DANIEL, CHIEF EXECUTIVE OFFICER AND FOUNDER, SILO FINANCIAL CORP.

Mr. DANIEL. Chairman Frank, Ranking Member Bachus, Congressman Himes, and committee members, thank you for the invitation to participate in today's committee hearing.

I am the principal and founder of Silo Financial Corp. from Stamford, Connecticut, which is a private real estate finance company that provides capital to small- and medium-sized real estate owners and developers.

I would also like to recognize that Jay Rollins of JCR Capital, a Denver-based private real estate finance company, has worked tirelessly with me on this initiative.

In reference to H.R. 5816, I trust that this program could provide smaller community banks with a means to underwrite and originate new qualified commercial mortgages, which they are currently unable to originate due to balance sheet issues, overexposure to real estate, and stringent regulatory oversight. The ability to finance more transactions could likely help create a floor for commercial real estate values and create work for many professionals, including electricians, plumbers, roofers, general contractors, pavers, and more.

Credit is the backbone of commercial real estate, and it remains extremely challenging for nearly all small balance commercial property owners to access mortgage capital. The convergence of declining fundamentals, lack of capital, and maturing loans have created a ticking time bomb of loan defaults, job losses, and property foreclosures that may sweep through this country worse than the residential mortgage crisis.

According to a 2007 study by NAIOP, the operating outlays associated with office, warehouse, and retail space built in 2007 alone are estimated to total $2.4 billion annually. This direct spending of building operations would add $5.1 billion to the GDP, support approximately 57,000 jobs, and generate $1.6 billion in new personal earnings. If we extrapolate the results of this study and apply it to the entire commercial real estate marketplace, encompassing over 32 billion square feet, then the impact to GDP and jobs is exponentially significant.

According to the Congressional Oversight Panel's report, "Commercial Real Estate Losses and the Risks to Financial Stability," hundreds more community and mid-sized banks could face insolvency, extending an already painful recession.

To address this crisis, we have developed a practical intervention initiative that, combined with H.R. 5816, could help contain and begin to remedy the commercial real estate crisis—at no cost to taxpayers.

Further, we are proposing a program where we, the lenders, will provide equity capital in a first-loss position, thereby insulating taxpayers from risk. In this program, the government would be a secured lender at no more than 50 percent exposure to today's real estate values.

We propose the expansion of the Small Business Investment Company Program to include the financing of small balance commercial real estate. The existing Small Balance Investment Company Act was formed in 1958 in efforts to provide capital to startup and capital-deprived companies and businesses. In light of the commercial real estate crisis, we are proposing the SBIC Act to temporary allow the participation of qualified small commercial mortgage lenders.

The Small Business Investment Company Program is a unique public-private partnership that has provided over $57 billion in financing to more than 107,000 small U.S. companies since the program's creation. There are hundreds of small real estate finance companies across the country, like Silo in Stamford, Connecticut, and JCR Capital in Denver, Colorado, which provide commercial real estate loans. Typically, these finance companies utilize private-sector equity combined with bank lines to make loans.

Unfortunately, these smaller finance companies are also prohibited from accessing capital themselves in this market environment. This, in turn, means even less capital can flow into commercial real estate markets. Thus, banks have less take-out options, values continue to decline, and community banks are forced to close.

The SBIC Debenture program, which has never lost money, would work perfectly to accommodate small real estate finance companies' need for capital in an effort to complement bank lending in this environment. Generally, SBICs have one-third of their own capital at risk in a first-loss position. So, for example, if ABC Real Estate Finance Company had $50 million of equity and was granted an SBIC commercial mortgage license, it could borrow $100 million at market rates and have $150 million to deploy and originate small balance commercial real estate loans with. To the extent these loans in a portfolio were made at no greater than 75

percent of today's values, the taxpayer's last dollar exposure would be no greater than 50 percent of today's values.

To conclude, the SBIC program would be a perfect temporary and complementary solution with H.R. 5816 until the traditional capital markets return to normal.

Thank you again for your invitation to discuss the important issues of today's hearing. I will be happy to answer any questions that you may have.

[The prepared statement of Mr. Daniel can be found on page 43 of the appendix.]

Mr. MINNICK. Thank you very much, Mr. Daniel.

Our next and final witness is Mr. Ernie Panasci. He was a shareholder at Jones & Keller and was introduced earlier by my colleague, Mr. Perlmutter.

Mr. Panasci?

STATEMENT OF ERNEST J. PANASCI, SHAREHOLDER AND DIRECTOR, JONES & KELLER, P.C.

Mr. PANASCI. Thank you.

Chairman Frank, Ranking Member Bachus, and members of the Financial Services Committee, thank you very much for the opportunity to testify at today's hearing on behalf of financial institutions in the United States.

As you stated, I am an attorney in Denver, Colorado, representing financial institutions throughout the western United States. My financial institution practice in the States in which it covers gives me a broad perspective on what is going on in community banks in the western region of the United States.

I am here today to discuss H.R. 5816, the Commercial Real Estate Stabilization Act of 2010, and complementary legislative regulatory proposals that would increase the availability of credit and improve the financial condition of financial institutions. My analysis of this bill leads me to believe it will be a step in the right direction to unclog the commercial real estate lending markets.

The old 8 and 10 percent capital guidelines imposed by the regulators have been replaced by 10 and 12 percent and, in some instances, far greater capital requirements on financial institutions. Most financial institutions are having a difficult time raising equity capital and, as such, are not able to make new loans because each dollar lent by a financial institution requires 10 to 14 cents in additional capital, depending upon the capital requirements imposed upon the institution.

The commercial real estate credit guarantee program would enable financial institutions to remove the guaranteed portion of these credits from their CRE portfolio, enabling them to make additional commercial real estate loans.

The program as outlined by the bill would be a benefit to financial institutions. However, I suggest the House consider limiting the maximum guaranteed amount to one institution to approximately 3 percent of its total risk-based capital as of a certain date and, if possible, increasing the amount of total guaranteed dollars to some amount in excess of $25 billion. My belief is that the Secretary of the Treasury will find a great interest in this program.

In addition to the commercial real estate guarantee program, I applaud Congress for its passage of the Dodd-Frank Act. In particular, I believe that section 616 of the Dodd-Frank act is very relevant to the proposed commercial real estate credit guarantee program and small business lending program. As you know, section 616 requires the Federal Reserve, in establishing regulations for capital standards, to take such standards into account as countercyclical economic conditions. In other words, in times of economic prosperity, the capital standards should be higher and, in times of economic stress, the capital standards should be lower.

With the combination of a decrease in the capital standards applicable to banks during these economic times and the implementation of amortization provisions of the small business lending fund program, overall, banks will be in a much better position to lend to businesses. I encourage the Federal Reserve to act on these countercyclical regulations as soon as possible, given the fact that we are still in the middle of an economic crisis.

While I believe the foregoing will provide some relief to financial institution lending and to financial institutions, I cannot stress enough the importance of the implementation of the temporary amortization authority currently provided in H.R. 5297.

As you are aware, Regulation H, enacted by the Federal Reserve in the 1980's, assisted agricultural banks with the amortization of agricultural loan losses. The FDIC report concerning banks that participated in this program states that, of the 301 banks operating in the agricultural capital forbearance program, 201 were operating as independent institutions 1 year after leaving the program, another 35 had been merged without FDIC assistance, and 65 banks failed. As these results indicated, after a period of forbearance, a large majority of the institutions in the program were either able to recovery or had sufficient value to be acquired. Losses of the 65 banks that failed were similar to those of other failed banks.

The combination of increasing capital demands due to the economic conditions that the country as a whole has been experiencing have contributed to a decrease not only in commercial real estate loans but also small business lending. Many bankers now realize that the loan portfolio diversification isn't necessary and are not able to undertake small business lending due to the aforementioned issues. Enabling institutions to increase small business lending would have a positive impact and would subsequently increase banks' capital.

I look forward to any questions you may have.

[The prepared statement of Mr. Panasci can be found on page 75 of the appendix.]

Mr. MINNICK. Thank you very much, Mr. Panasci.

And I thank all the members of the panel for their thoughtful testimony and for rearranging your schedules to be with us today.

I would like to start by asking Mr. Lindsey: You heard the testimony of two of my colleagues, in their opening statements, that this legislation was ill-advised and untimely from the standpoint of creating additional risk to the taxpayer and would cost the taxpayer, potentially, and was indirectly another form of bailout.

In your testimony, you indicated you thought exactly the opposite was the case. Could you explain to us, again, why?

Mr. LINDSEY. Yes. And I wish they were here to hear my answer.

The structure of this program calls for a 2 percent guarantee, and that is a minimum fee, to be paid to the Treasury Department. I think that fee is probably 4 to 5 times what the industry used to charge for ensuring a similar risk.

What we are talking about here is the Treasury Department, what we call in the industry, wrapping investment-grade bonds to Triple A bonds. By doing that, what they do is they help private industry accumulate loans. Because, right now, the biggest risk to securitization is the accumulation of loans in preparation for securitization. The big banks are worried that something may happen in that 6-month period of time that makes them keep all these loans on their balance sheet or have to fire-sell them into the market, and they are very hesitant to do it.

So, I think the 2 percent fee that is in the program is more than enough to cover any costs or projected losses. And, of course, we would be modeling with the Treasury Department the structure and creating the default models that would make sure that was the case. I think that the legislation is written to make sure that it is at least neutral to the taxpayers.

Mr. MINNICK. And, Mr. DiAngelo, you indicated that another cost of doing nothing might be a substantial number of commercial banks going under, being seized by the FDIC, and that those costs would also accumulate to the taxpayer.

Could you elaborate as to why those costs might be incurred if this legislation is not passed?

Mr. DIANGELO. Yes. Most of the bank failures that have been occurring at the community bank level have been, frankly, due to this problem, the commercial real estate problem, and particularly, even more narrowly, the small balance commercial real estate loans.

Again, the FDIC is not set up to proactively deal with these problems. It can only deal with a bank once it is in receivership. There is really, at the moment, no agency that can tackle this particular problem. When the problem was tackled in the 1980's and early 1990's, the government set up the RTC as a separate entity to deal with it. But, once again, I think that was from receivership estates. It was essentially taking a job that the FDIC is doing now on its own and creating a separate entity just to do those transactions.

We don't have that today, so the FDIC—it is funny, the FDIC—we, collectively, have really asked the FDIC to do a job that it was not set up to do, which is to try to respond to a lack of liquidity in the commercial real estate lending markets. So what happens is, you have an agency that is really not set up to tackle this problem, but by default it tackles it anyway; any losses roll to the deposit insurance fund, which is not precisely a taxpayer-supported fund, it is funded by bank assessments. But I would imagine that the bank assessments somehow gets passed on to the bank customer, so the difference between something that like and a tax is probably fairly small.

So my point on this is that the sooner we could get to this problem, probably the less cost it is going to be writ large to the banking industry and the public.

Mr. MINNICK. Thank you.

And, quickly, Mayor Craft, you indicated in your testimony that you thought 1,500 banks may be at risk if we simply let the market play out. Do you have an estimate for us of the cost to the customers and taxpayers if that free-market scenario plays out?

Mr. CRAFT. Yes, sir. We, in our small community, have 32 miles of beach area, and we are a very small portion of the entire Gulf Coast community affected. We have existing about $1.3 billion worth of debt in acquisition, development, and operational costs. And we are severely impacted. All of the economy within this region is either tourism or fishing, both of which are highly seasonal and have been devastated with cash flow. And that will flow back on the banks as we try to make the payments on existing credit and try to survive to the next season.

Mr. MINNICK. Thank you, sir.

Ranking Member Bachus?

Mr. BACHUS. Thank you.

Let me say that the testimony has been very helpful this morning, and I think there are several proposals in the testimony that merit consideration. And I think one thing that I take out of this hearing is that the risk of not doing something is greater than the risk of doing something; and that if it is well thought out, that the exposure to the taxpayer will be minimal, and that we can protect the taxpayer, and that any losses actually could be minimized that the taxpayer would take. So we will take these proposals very seriously.

And, also, I would like to, I guess, associate myself with the testimony several of you had, that the way to create jobs is small business and small business lending. Many of our programs to date have been, I think, designed to help the larger institutions. And that is a significant failure that we have had over the past 2 or 3 years; we have neglected the smaller institutions. And a lot of these programs that have gone out before were smaller institutions, and our regional banks even, on occasion, weren't able to take advantage of that.

It has also created a perception, which I think is true, in the general public that our larger institutions, both by the regulators and by the response, have been protected and insulated, when, really, a lot of the risk-taking and what happened was a direct result of some of their activities, and that our smaller banks and our businesses and commercial real estate is more of a victim of what they did. And it is really not a fair approach that has been taken.

So we will not dismiss these proposals as simply more exposure to the taxpayer, I can tell you, speaking for myself and at least some of the other members.

Let me ask Mayor Craft: If the bank regulators don't respond positively to the relief you are seeking from the coastal community banks, what would you suggest the Congress do?

Mr. CRAFT. Take some type of legislative action to help. We cannot survive as a community without our regional and local banks. With the season out there, it is as important to our economy as our fisheries and our lodging industry, either one.

So we have to have survival of our banks. And if we don't take some action, particularly as it relates to the reappraisal—which I know the valuations are going to be quite a bit less than the loan

value, probably, and we do not have the availability to meet a cash call as a community. So we certainly need some legislative help.

Mr. BACHUS. All right. Thank you.

My second and last question, Mayor Craft, you state that real estate prices that existed pre-spill in the early part of this year will return after the leak is stopped and the beach is cleaned up. In fact, a lot of them are clean today. I think you keep getting the same picture of the same beach, and it affects the tourism.

What is your basis for that assumption?

Mr. CRAFT. Very little of the real estate holdings that are mortgaged and financed are residential real estate. Most of it is investment real estate. It participates in the tourism economy. Once the tourism economy improves, the values will go up with it.

And we are becoming confident that, with Mr. Feinberg, in our discussions and meetings with him, that he understands the urgency and understands the requirements of funding the cash revenue that has been lost in these industries in the past year.

Mr. BACHUS. All right.

Let me say to Congressman Minnick and others, I think one strong argument for addressing this problem, particularly helping the community and small banks, is we have this so-called doctrine that has become pretty infamous over the last 2 years of "too-big-to-fail." And what we have done with a lot of our actions are grow the largest banks to the point where they are about 50 percent bigger than they were before the crisis.

So, as we continue to lose our regional and community banks, we are going to be in a situation where we are going to create even larger institutions. And one of my somewhat disappointments about this legislation was we did create a "too-big-to-fail," where we said that if they fail, the government would, at least in an implied way, come in and bail out the creditors or counterparties. I believe in America you should not create two classes. And, actually, it makes their cost to capital less.

So, I will be interested in seeing how the regulators respond to that. Because they literally begged us to give them the authority to step in and help these "too-big-to-fail" institutions, which are getting bigger by the day.

Mr. MINNICK. I would like to thank the ranking member for those thoughts and also for his suggestion that this important problem which faces Main Street be addressed in a bipartisan fashion. Thank you.

The Chair calls on the gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. I want to compliment the chairman on how good he looks in that chair up there. He looks very comfortable.

I don't want anything I say here to suggest any animosity toward the bill that we have been talking about. I actually support it. But there are some realities here that my colleagues on the other side have pointed out that raise some interesting questions, because most of them are very much free-market people. They don't want the government to do anything that is involved in the free market. And I suspect, when I talk to most constituents of mine who fit the demographic profile that our witnesses seem to fit, that most of them are free-market people too.

So we are constantly in this battle of how much should government be doing versus the private sector. And this is a government program, because, at some level, what is being proposed is making government the backstop, taxpayers the backstop for this. I support that. I have been supporting it for years in various contexts, similar to the SBIC proposal that Mr. Daniel testified about, the MESBIC program that we have been talking about for years to try to stimulate development and investment in minority and underserved communities.

But there are some troubling things I have heard in this testimony today also. And one of those came from Mr. Helsel when he said that he had this balloon loan, and he got to the end of the amortization period and his option was to refinance. And Mr. Lindsey reaffirmed that, because he said real estate mortgages are never intended to be amortized completely.

You take the combination of those two things, and that is a troubling position that you are in. Because most of the people I know, when they get a short-term balloon loan and they get to the end of it, they know that they have an obligation to pay that loan, not to refinance it.

That is the same thing that we have criticized the speculators about. You got a lower interest rate on a 10-year loan with a balloon on it than you would have gotten on a 30-year loan had you fully amortized it.

So do I understand that the real estate market is not set up anymore to amortize loans ever? Do we always contemplate that they would be refinanced at the end of some payment term? That is a troubling notion to me, because I never thought of that. And I practiced law in this area for 22 years. When we got a loan, we expected to pay it. And that is the kind of personal responsibility that we have been preaching to every borrower in this country.

So, tell me I misheard you when you said what you said, or tell me what the rationale for this is.

Mr. HELSEL. Congressman, the fact is that most commercial loans are never set up to be paid off over the balance of the entire mortgage.

Mr. WATT. But should we be encouraging that as a proposition?

Mr. HELSEL. I am not sure if we should encourage it or discourage it. It is the system that we work in. And the system we work in says that we will give—

Mr. WATT. But that is not the system we work in for anybody else in this country. You borrow money, and you pay it back at some point. Or you assume the risk, not the taxpayers assuming the risk.

Mr. HELSEL. I guess I would say that, under a residential scenario, I would agree with you. But the fact is that, in order to make a commercial transaction work, many times the only way to drive down the cost of the mortgage is to take a loan, as you suggested, which gives you a lower rate at the front end, recognizing you are going to refinance it sometime over the balance of the total period of that loan. And that is about $1.4 trillion in loans that are going to come due over the next 18 months to 2 years. So that is the situation we sit in right now.

I would have been happy to take a 20-year loan at the rate I had been given. Unfortunately, I didn't have that opportunity by the banks.

Mr. MINNICK. The time of the gentleman has expired.

Mr. LINDSEY. One thing the securitization model can do is extend longer amortization—

Mr. MINNICK. The gentleman's time has expired.

The Chair recognizes the gentleman from Texas.

Mr. WATT. Could I just request that they submit their answers to the questions that I posed in writing? We can't do this in 5 minutes, so I would like to get written responses to the questions, if I could.

Mr. MINNICK. The Chair asks the witnesses to respond in writing to the gentleman from North Carolina.

Mr. Green?

Mr. GREEN. I pass.

Mr. MINNICK. The Chair recognizes the gentleman from North Carolina, Mr. Shuler.

Mr. SHULER. Thank you, Mr. Chairman.

I also want to thank the ranking member for his comments, as well.

I first want to tell Mayor Craft, our heart goes out to people in the Gulf region. I spent some time in Louisiana, and I know the whole Gulf Coast has been hit numerous times now. It is just, how much can you take?

So, you start to realize, being in North Carolina, most of your folks, when they retire, they will move to the mountains of North Carolina. And what is happening is, because of the commercial real estate, the endeavors that they have been in in the Gulf region and the depreciated value that they have now on their real estate, they can't get that home equity loan or they can't sell their home to the value that they have in it. So that is prohibiting them to actually come into my region. We see how that has a huge impact on our region. So our heart goes out to all the people in the Gulf region, and hopefully it all gets cleaned up and gets the economy back up.

To Mr. Lindsey, what happens in a normal real estate process from the standpoint of if a bank has a bad, let's say, developer, who has a strip center, $7 million valued on it, and that person hasn't does his performance, he is not a very good manager, he doesn't have good anchor tenants, what happens to that piece of property? What impact does it have to the person right across the street, who has a very similar value of real estate? What happens to the manager who has done very well and gotten great anchor tenants and has never missed a—what happens to his real estate value?

Mr. LINDSEY. As real estate values decline—in your example, if there were two similar properties across the street from one another, and one is in trouble with the bank, someone like myself—and I have done it—would buy that property at a substantial discount.

I can give you a real-world example. We purchased a note from a bank. The note was $6 million. We paid $825,000 for it. The original valuation of the property was about $8 million. There is a sister center across the street. Our property was less than optimally occupied. The one across the street was almost fully occu-

pied. The strategy for us, because our cost is so low, will be to cut rents in half, go across the street and get the tenants from the people over there. By the way, that particular property happens to be also bank-owned.

So we will take those tenants, put them into our building, and then buy that building from them at a substantial discount and then re-tenant it. Whenever there are loans clearing at these very low valuation levels, the first thing that we do is cut rents and fill up our buildings.

If you look at what happened in the RTC, there were formulas that most of the market was using at the time where you just look at the property and say, "I have to cut rents to 60 percent of market," let's say, and "I want a 10 or 12 percent rate of return, and that drives my purchase price," and that is what they did. But the problem with that is it pulls the entire real estate complex down. I think ultimately it affects everything.

Right now, you see some healing in the bigger part of the market. I am talking about trophy properties. There are transactions happening there. And I think the market feels like they are insulated from the risks that we are talking about today. I disagree. A $10 million loan supports a pretty big property. And if guys buy those at substantial discounts, they are going to start poaching tenants out of these big buildings, and, ultimately, those big buildings will start to decline in value, as well. They are not going to escape this, in my opinion.

Mr. SHULER. What would be the impact if, let's say, the project that has full tenants was owned by an individual? Would you say that person's value would decline such that they may not have the opportunity to use some of the equity in that piece of real estate to go out and create another job or create another business or buy another piece of real estate?

Mr. LINDSEY. I totally agree with you. To the extent you have equity destruction of any type—and, like I said in my testimony, there has been $2 trillion worth of equity destruction. In the past, people would have been able to borrow money based on the value of their real estate and do something. Right now, what everybody is doing is paying off debt instead of investing it in their businesses. It is a very serious problem.

Mr. SHULER. Mr. Craft, do you kind of see the same thing? If something happened to—I guess you own a sod farm, and let's say one of your competitors ended up in a bankruptcy situation and they did a short sell on the courthouse steps. And let's say it was a $6 million piece of real estate and they bought it for $600,000. Think about the impact. That is going to have significant impact on the valuation of your own product.

Are you starting to see some of that in the Gulf Coast? And I know that we have the problem with the BP situation, but there have been a lot of problems, certainly, in the Gulf Coast region for the last 2 years, well before BP came in and kind of compounded that problem. Have you started to see where the banks are, kind of, locking some of these businesses up based upon maybe bad practices of a competitor?

Mr. CRAFT. Absolutely. And when we have that situation, not only does your competitor buy a piece of property at a much lower

price, he has a much lower cost. And so he has a competitive advantage over those of us who are in business who have stayed solvent. So it has a definite impact.

Mr. SHULER. Thank you, Mr. Chairman.

Mr. MINNICK. Thank you, Mayor Craft.

The Chair recognizes the gentlewoman from Florida.

Ms. KOSMAS. Thank you, Mr. Chairman, and thank you for the opportunity to work on this legislation with you.

I want to thank all the members for being here today.

I think since I have been here, for the last 18 or 19 months, I have been pretty vocal and outspoken about this issue, which I think has been under the radar screen for many people, I think, for two reasons: one expressed by a colleague a few minutes ago, where the average person walking down the street doesn't even know that commercial real estate loans come due, are rolled over, refinanced, whatever term you want to use, on a regular basis. So they assume that all real estate lending, including commercial real estate lending, has the potential to be at a 20- or 30-year fixed rate, which, of course, we know is not true. So, perception-wise, we are in a dilemma, where, for most people, they don't recognize the problem. So I appreciate very much the opportunity to put this focus on it.

I also wanted to thank Mr. DiAngelo, particularly, for pointing out the very close connection between the viability of the community banks and the credit and services that they provide for small businesses in our communities and what that has to do with job creation, economic stability, and economic growth. It is also unrecognized by many people that those small businesses we hear about frequently create 60 to 70 percent of new job opportunities, and they cannot function, they cannot do that if they do not have access to credit.

And the reasons that have been outlined today that they don't have the opportunity to move forward, make loans to those folks, particularly those with whom they have long-term, good relationships. And, in many instances, performing loans that have never been delinquent are being called due in ways, as I say, that are unfamiliar to most people.

So, mostly I want to thank you all for being here, helping us put this into focus. I appreciate the comments, also, of the ranking member, that he recognizes that this is a bipartisan, commonsense solution that will be helpful both to small businesses and to the community banks that provide so many great services to those small businesses in creating jobs.

I want to identify, also, with Mayor Craft and the comments he made and the comments made by others about the appraised value of real estate and the difficulty that puts into the equation. But, being from Florida, we also are experiencing much of the same problem that you are, with regard to the oil spill. Frankly, in a State that is built on tourism, even the perception of oil on the shores affects our ability to attract visitors. And so we end up in the same dilemma that you are, whether or not our shores are actually affected to the same degree that yours are. So I want to make sure that we are in a position that we can continue to work

with you in trying to find a solution crafted specifically to that dilemma.

Some of the proposals that have been made provide for an 18-month period of relief from the usual appraisal requirements in order to allow the markets to more rationally value real estate along the Gulf Coast.

Do you have a time period in mind? Or what time period might you suggest if there were a way in which the Florida delegation, along with the delegations from the other Gulf States, could come together? Is there a timeframe specifically that you would recommend?

Mr. CRAFT. I think 18 months is a reasonable amount of time. We feel fairly confident that we are well-positioned without this layer of an additional level of threat to our business operations that we will recover from the oil spill and we will recover once we start getting the moneys paid. And so, in 18 months, I think we will be stabilized as a business economy, in the hopes then that will raise the valuation up.

Ms. KOSMAS. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Mr. MINNICK. The Chair recognizes the gentleman from Colorado.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

And I apologize to the panel that I had to step out for a meeting on these very subjects with one of the members of the regulating community.

I would like to focus my first question to you, Mr. Panasci. In your experience representing different financial institutions in Colorado and the Rocky Mountain West, when—sitting on this committee, we saw a heart attack occur on Wall Street about 2 years ago. And then those ripples now have reached other States, obviously, for some time.

Have you had any experiences with any of the financial institutions you represent or know about where they had good loans that had been examined, and then they go from a number one bank, CAMEL 1 or whatever they call those, to something else? Can you elaborate?

Mr. PANASCI. One of the perceptions and, I will say, positions espoused is that these bad loans were made relatively recently. A lot of the loans that the banks are having problems with today are loans that existed in their loan portfolio for years, prior to 2007 and earlier.

And these loans were on the books of the banks at a time when they were CAMEL 1- or 2-rated banks, which are the best CAMEL ratings you can have is 1 and the worst is a 5. And then all of a sudden the regulators come in, they examine the portfolio, and perhaps correctly, and all of a sudden the CAMEL rating goes from a 2 to a 4, or a 1 to a 4 or a 5. And those loans existed in the portfolio for many years when they had a higher CAMEL rating. It wasn't as if the bankers immediately got stupid and starting making bad loans. These are loans that existed over a period of time.

So there is a tremendous impact on the economy. And everybody here has talked about what happens, what the spiraling effect will

be based on the decrease in values of commercial real estate that could come and probably will be coming in the future.

So these loans existed for an extended period of time. And I can tell you, based on my experience, I meet with the regulators constantly, and I represent a lot of financial institutions throughout the West. And in my meetings, the bankers are very tired, and a lot of them want to get out of the industry. But you know what? The regulators are tired, too. They go in, and they are delivering an ugly message to the bankers. The bankers receive the ugly message. And everybody is tired.

And the industry needs help. There is no question about it. What you don't want to have is 1,500 banks fail, because just look at the statistics on bank failures and the realization on the assets that the FDIC seizes. It is anywhere from 60 to 70 percent loss on these institutions. And if you take that across-the-board in commercial real estate, you are looking at some real problems.

I am very familiar with Congressman Minnick's area because I represent some banks in the State of Idaho. The Boise area is having an extremely difficult problem right now in commercial real estate.

So there is a number of solutions that can be undertaken to help resolve these problems, and I think the bills that you are looking at right now are very important. I cannot overemphasize the importance of a loan loss amortization program for these banks, like we had in the 1980's for agricultural banks. These banks are profitable, pre-loan loss reserve, their operating profits are there; they can work through these problems. They are better equipped to work through the problems than the FDIC.

If you remember, the Department of Liquidation was established in the 1980's and closed down in the 1990's when the economy improved. What makes us think that the FDIC is well-equipped to start up a Department of Liquidation again? It is a new agency, in essence, a subdivision within the agency. So it is a big problem, and it is going to continue to get worse.

Mr. PERLMUTTER. I thank you.

And I think the whole point of this—and I appreciate the gentleman from Idaho bringing this bill and having this panel—is about weathering the storm and having institutions standing when things turn, whether it is 18 months or 36 months or whatever it might be, so that we can continue to have competition among the banks in this country and opportunities for small businesses to work with local bankers. That is the bottom line for me, because it is those small businesses that are going to put a lot of people back to work.

And, with that, I will yield back to my friend from Idaho.

Mr. MINNICK. I thank the gentleman.

Does the ranking member—

Mr. BACHUS. I have an article from the American Banker, and I would ask unanimous consent—this is by George LeMaistre, dated Friday, July 23rd, entitled, "Viewpoint: Give Gulf Banks a Break on Property Appraisals"—I would like to submit for the record.

Mr. MINNICK. Without objection, it is so ordered.

With the ranking member's permission, I would like to ask Mr. Lindsey one additional question.

Mr. Lindsey, in your earlier comments, you indicated that this program should make the government money, not cost the government money, so that it was the opposite of a bailout. You also indicated that you thought that this was a temporary problem.

Could you explain how the pricing of the program would lead to starting the market but then it no longer being necessary in a short period of time?

Mr. LINDSEY. Sure. The program does have a 3-year sunset, but I really think that it would be, hopefully, sparingly used. And the reason is, that with the 200-basis-point or 2 percent guarantee fee—and that is paid annually—the profit incentive for the free market to step in and take the government out of that business is incredible. Two percent on a 10-year-type program such as this, if that was the longest term we did, and that is what I think it says in the bill—

Mr. MINNICK. And you are in this market, so you are talking from personal experience?

Mr. LINDSEY. Yes. I was in it for a long, long time. And we wrapped investment-grade risk to Triple A in the 1990's, and we paid much less than 200 basis points for our wraps, for our insurance to Triple A.

So I think it leaves so much room for the free market to come in as the market stabilizes, that they will. And I actually think that the bond market, right now, today, would probably facilitate the private market being able to go ahead and sell bonds into the marketplace without the guarantee. But the marketplace is afraid that, in an accumulation period that I talked about earlier, that the market dramatically changes and that they can't sell bonds.

So what this does is it gives them an option to use the guarantee program or place the bonds into the free market. And that is obviously what I think most of the people on this panel would hope, that the free market steps in and takes over this market. Because a $25 billion program is not going to solve this problem. So we need the free markets. We need this to jump-start the free markets, and that is what it is designed to do.

So I think it is pure profit incentive that gets this program into the hands of the private industry.

Mr. MINNICK. And if I—I can't remember whether Mr. Daniel or Mr. Panasci analogized this program to what happened in the early days of the TALF program, where the program did, in fact, jump-start the market and then the free market took over and it was no longer guaranteed. Is that—whomever made that comment.

Mr. DIANGELO. Yes, that is correct. That program was announced, and it got used less and less every month, and, finally, it evaporated.

Mr. MINNICK. And you would envision that would be the case for this program, as well?

Mr. DIANGELO. Yes, based on Mr. Lindsey's observations about the—

Mr. MINNICK. And that was your experience as an attorney as these markets got started, and you lived through that TALF experience, as well? Is that correct?

Mr. DIANGELO. Yes. Exactly.

Mr. MINNICK. Thank you.

Does the ranking member have any additional questions?

Mr. BACHUS. No questions.

Mr. MINNICK. Then the Chair would like very much to thank all the members of the panel for being with us today. It takes a lot of time and effort to come to Washington. We appreciate your testimony. It was very prescient. And it will be available to all the members of the committee and our staffs. So we appreciate your insight into this very difficult issue.

The Chair notes that some members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This hearing is adjourned.

[Whereupon, at 12:00 p.m., the hearing was adjourned.]

A P P E N D I X

July 29, 2010

Written Testimony of Robert Craft
Mayor, Gulf Shores Alabama

Before the House Financial Services Committee
July 29, 2010

Chairman Frank, Ranking Member Bachus, and Members of the Committee, first let me state again how much the coastal residents along the Gulf of Mexico appreciate your interest in our region in the aftermath of the BP oil spill.

This hearing concerns possible legislative efforts to address the on-going difficulties in the commercial real estate market. Of course, these difficulties have had a very significant impact on the Alabama Gulf Coast. Property values have fallen in our community as they have fallen elsewhere.

Banks that provided credit to our community have been significantly damaged. Over the last several years, these banks have charged off tens of millions of dollars in loans in Gulf Shores alone. But now federal bank regulators are requiring further write offs based on the temporary loss of real estate value given the uncertain conditions created by the oil spill.

Once the leak is stopped and the beaches are cleaned up, tourism will return and property values will return as well. This doesn't mean they'll return to 2006 valuations, but they should return to pre-spill valuations. In fact, Mr. Feinberg has stated that his

BP escrow fund claims process will not recognize real estate claims for just this reason...real estate values are only down temporarily.

Unfortunately, the bank regulators are aggravating the problems on the coast by various actions that they have taken. The interagency statement that these regulators issued is of no value either to the affected banks or to the residents of the Gulf Coast. The statement urges banks to waive late fees and ATM charges, gestures of no meaning.

Our banks have had federal bank examiners force them to write off millions of dollars in performing loans that are current simply on the basis that the underlying collateral has lost value since the oil spill. This makes no sense. It just makes recovery of the region that much more difficult.

Without help, Gulf Shores and Orange Beach could lose what has taken decades to develop across multiple generations of families. With the loss of business revenue, Gulf Shores and Orange Beach are at risk of losing businesses needed to serve the driver of our island economy, tourism. Once this business infrastructure is lost, it can't be magically recreated.

Every business located on the island is directly affected by this disaster and has suffered loss. There are no exceptions. From the beginning of this disaster, our

community has been assured that we would be made whole by BP. This has not occurred.

The financial impact of the oil disaster is devastating. Our local community of Gulf Shores and Orange Beach has approximately $1.3 billion in debt that is dependent on tourism revenue. The two cities have a permanent population of 15,000, but between Memorial Day and labor Day, we have a population of 150,000.

The Gulf Coast would urge this Committee to work with the federal bank regulators to provide its banks time to work out of the problems created by this spill. They need more than an interagency statement on ATM fees. Here are a few concrete examples of what is needed.

Appraisals. Bank regulators continue to insist on new appraisal valuations even though the real estate market is so unstable as to make meaningful comparables impossible. It is essential that bank regulators accept existing pre-spill valuations, not distressed valuations caused by arbitrary valuation mark downs in the aftermath of the spill.[1]

Bank Examiner Recognition of Feinberg Claims. Bank regulators ought to recognize BP and Feinberg claims as equivalent to insurance claims, when those

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1 A year from now, once the leak is stopped and the beaches cleaned up, the real estate market will have stabilized and reasonable market values can be determined. In the meantime, the uncertainties make it impossible to determine real market value.

claims are corroborated with data. Thus, examiners ought to take these claims into account when assessing the repayment prospects of a loan.

Other Relief. There are several other steps that the regulators ought to take with respect to banks invested along the Gulf Coast.

- Bank regulators, as they are classifying loans and requiring charge offs, ought to consider the reality of the temporary nature of the loss in value.
- Another reality that they should consider is the effect this spill has had on coastal banks' raising of capital. The investor community has begun to reenter the bank capital market, even for troubled banks. But the investor community has indicated that it wants to let the market settle after the spill is over before investing in these banks. The regulators should work with the banks to give them more time to raise capital.

In sum, the bank regulators need to give these banks some breathing room. And, in the long run, this will reduce the cost to the taxpayer by saving many of these banks and also allow lending to begin again in the affected area.

Finally, these points are exactly in line with the letter that Chairman Frank and Mr. Minnick sent the federal bank regulators in the fall of last year. I am told by bankers that the regulators have not responded in the requested manner. We appreciate this Committee's interest in the problems we confront on the Gulf Coast, and we would deeply appreciate any help you could provide in obtaining the relief mentioned here and

in Chairman Frank's and Mr. Minnick's letter of October 29, 2009, attached to my testimony.

Thank you.

TESTIMONY OF
JONATHAN DANIEL
CEO AND FOUNDER
SILO FINANCIAL CORP.

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ENTITLED
"ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES AND INCREASING JOB GROWTH"

JULY 29, 2010

SILO FINANCIAL CORP.
TWO LANDMARK SQUARE, SUITE 208
STAMFORD, CT 06901

Chairman Frank, Ranking Member Bachus and committee members:

Thank you for the invitation to today's committee hearing to discuss Alternatives for Promoting Liquidity in the Commercial Real Estate Markets, Supporting Small Businesses and Increasing Job Growth. Before I begin, I would like to provide a brief overview of my background and qualifications. I am the principal and founder of Silo Financial Corp. which is a real estate finance company that provides capital to small and medium sized real estate owners, developers and investors. I have seen first hand how the times of easy credit over-fueled the business, and created irrational behavior. I now see how the lack of credit is destroying their companies, costing jobs, and continuing to create a downward spiral in real estate valuations, especially for the projects of $10MM or less. Since 1994 I have actively been involved in Commercial Real Estate Finance. In 2001, I founded Silo Financial Corp. My expertise lies in commercial real estate lending to small and medium sized developers, with project sizes of $10MM or less. I would be remiss if I didn't mention that Jay Rollins of JCR Capital who has a 25+ year track record in structured Real Estate Finance, but who could unfortunately not be here today, has worked tirelessly with me in our efforts to pursue this SBIC lending initiative.

I am certain that this committee is aware of the $1.4 trillion of maturing commercial real estate debt, which represents 40% of all commercial real estate debt. In an effort to save time, I have opted to not dwell on the overload of disturbing statistics about the commercial real estate marketplace. This pending debt disaster, combined with a weak financial system, no viable CMBS market, and no capital available to private lenders, will exacerbate the current problems and cause the real estate recession to deepen. These factors continue to drive down the value of commercial real estate and are the root cause of failure of our nation's community banking network.

In reference to H.R. 5816, I trust that this program could provide smaller community banks with a means to underwrite and originate new qualified commercial mortgages, which they are currently unable to originate due to balance sheet issues, over exposure to real estate and stringent regulatory oversight. It is essential for community banks to be able to provide businesspeople in their communities with small balance commercial real estate loans. Furthermore, the ability to finance more transactions could likely help create a floor for commercial real estate values and create work for many professionals including, appraisers, engineers, attorneys, real estate brokers, mortgage brokers, construction workers and more.

I would like to speak about the actual commercial real estate credit markets from where I am sitting on a daily basis. Credit is the backbone of commercial real estate and it remains extremely challenging for nearly all small balance commercial property owners to access mortgage capital. Please note that we define small balance commercial properties as properties with less than $10mm of existing or required debt. The exception to my previous statement includes few situations, which in scale are not meaningful to the overall market. This includes small businesses which own and occupy at least 51% of a property in conjunction with having adequate financials can presumably qualify for SBA financing. In addition, some might say that well capitalized borrowers, with nearly 100% occupied

buildings and strong rent rolls, can still get financing (just like many wealthy home owners). But, the vast majority of small balance commercial borrowers find themselves without sufficient cash as:

1. These projects no longer provide steady cash flows due to declining rents and declining occupancy.
2. Their banking relationships are no longer strong, as most of these borrowers were clients of community banks who have suffered the most in this financial crisis. These community banks were the credit backbone of these borrowers.

The convergence of declining fundamentals, lack of capital (especially at community banks), and maturing loans have created a ticking time bomb of loan defaults, job losses and property foreclosures that will sweep through this country like the residential mortgage crisis. It has only been delayed by low interest rates and bank extensions, but this cannot go on forever.

Commercial Real Estate Linked to Small Business

As far as the commercial real estate industry and its relations to jobs, I would like to specifically point out that the commercial real estate marketplace is directly linked to jobs, GDP output, tax revenue and in of itself is a very large industry sector in our country's struggling economy.

The following facts which I will share have been taken from a 2007 Study by NAIOP titled "The Contribution of Office, Industrial and Retail Development and Construction to the US Economy;"

1) The value of commercial buildings extends well beyond their initial construction value. In order to substantiate the full measure of this value, the pre-construction, construction and **post-construction outlays** associated with commercial buildings must be calculated.

2) While the construction impacts of building 851.5 million square feet of new building space during 2007 represents a significant contribution to GDP, job and income growth nationwide, these new buildings continue to provide economic benefits to their host economies after their construction is complete. These economic impacts include **outlays required to maintain and operate these buildings and the value of their productive output. The operating outlays associated with the office, warehouse and retail space built in 2007 are estimated to total $2.4 billion annually. This direct spending of building operations would add $5.1 billion to GDP, support 56,887 new jobs and generate $1.6 billion in new personal earnings**.

These statistics mentioned are only related to the 851 million sf constructed in 2007. Should we take these figures and multiply them by 30 times over, due to the fact that this country has over 32 billion sf of commercial real estate, then the numbers would be astronomical. These operating outlays are annual and recur yearly over the life span of a

building. Similarly, the potential productive value of these new building spaces represent a significant annual contribution to the local, state and national economies, as does all commercial real estate.

I will now paraphrase two paragraphs from the Congressional Oversight Committee's Executive Summary in connection with Commercial Real Estate and its link to small business credit. I quote, "It is difficult to predict either the number of foreclosures to come or who will be most immediately affected. In the worst case scenario, hundreds more community and mid-sized banks could face insolvency. Because these banks play a critical role in financing the small businesses that could help the American economy create new jobs, their widespread failure could disrupt local communities, undermine the economic recovery, and extend an already painful recession.

There are no easy solutions to these problems and no one program can solve these complex issues. Although it endorses no specific proposals, the Panel identifies a number of possible interventions to contain the problem until the commercial real estate market can return to health. The Panel is clear that the government cannot and should not keep every bank afloat. But neither should it turn a blind eye to the dangers of unnecessary bank failures and their impact on communities."

To this point, we have developed a practical intervention initiative that could help contain and begin to remedy the commercial real estate crisis at no cost to taxpayers, and in fact, we are proposing a program where we the lenders will provide the equity or first lost capital. In this program, the government would be a secured lender at less than 54% exposure to today's value % LTV, at market rates, with private capital taking the loan share of the risk. Let me explain.

We would like to propose the expansion of the SBIC Program to include the financing of Small Balance Commercial Real Estate.

The existing Small Business Investment Company Act was formed in 1958 in efforts to provide capital to startup and capital deprived companies and businesses. In 1972 the ability to fund or invest in real estate was prohibited. In light of the commercial real estate crisis we are faced with, we are proposing a temporary lift of the Real Estate prohibition in the Small Business Investment Company Act.

The Small Business Investment Company (SBIC) Program is a unique public/private partnership that has provided $57.2 billion in financing to more than 107,000 small U.S. companies since the program's creation in 1958.

The mission of the Small Business Investment Company (SBIC) is to improve and stimulate the national economy and small businesses by stimulating and supplementing the flow of private equity capital and long term loan funds for the sound financing, growth, expansion and modernization of small business operations while insuring the maximum participation of private financing sources. We believe in the midst of this Commercial Real Estate Crisis the SBIC mission is an ideal fit to address this problem.

There are hundreds of small Real Estate Finance companies across the country, like Silo located in Stamford Ct and JCR Capital located in Denver CO, which provide commercial real estate loans, some public and mostly private. Typically these finance companies utilize private sector equity combined with bank lines or credit facilities to make loans. Unfortunately, the state of the commercial real estate market, coupled with the state of banks' balance sheets and their over exposure to real estate is prohibiting these smaller finance companies from accessing capital themselves. This in turn means even less capital can flow into the commercial real estate markets. This in turn causes banks to have less take out options, values continue to decline, and community banks are forced to close. **The SBIC program would be a perfect temporary fit until the traditional capital markets get back to normal.**

It is our understanding that the government has never lost money through the SBIC debenture program and it is in fact this debenture program, which would work perfectly to accommodate small real estate finance companies need for capital in effort to compliment bank lending in this environment. Presumably the success of the SBIC program and taxpayer protection is simple. SBIC's must have ¼ but in most cases 1/3rd of their own capital at risk in a 1st loss position. So for example, if ABC Real Estate Finance Company had $50mm of equity and where granted an SBIC Commercial Mortgage license, it could essentially borrow $100mm at market rates and be able to deploy have $150mm to deploy in the form of commercial real estate loans to small balance borrowers. To the extent, these loans in a portfolio where made at an average of 75% LTV or less, than the taxpayer's last dollar exposure would be no greater than 50% of today's appraised value.

Conclusion

While financial market conditions have improved in the United States, the overall lending environment remains strained, and significant concerns have been raised about the availability of credit to small businesses. Therefore, we are asking, suggesting and recommending that you consider either (a) a new program, much like the successful SBIC program to provide leverage to small commercial real estate finance companies or (b) to temporarily strike the prohibition of real estate under the current SBIC guidelines to allow access to leverage for small commercial real estate finance companies. This could be a practical and successful vehicle to assist the small bank commercial real estate borrowers in this time of crisis. We believe we have modeled a program that can provide capital, jobs, and assist community banks, all at no cost to taxpayers. We ask for your support, as Silo and JCR continues its work with the SBA to establish the Commercial Mortgage SBIC program.

Thank you again for your invitation to discuss these important issues at today's hearing. I would be happy to answer any questions that you may have.

Testimony of Chris DiAngelo
Dewey & LeBoeuf Partner
July 29, 2010

Chairman Frank, Ranking Member Bachus, Members of the Committee, I appreciate the opportunity to discuss the topic of the Commercial Real Estate Stabilization Act today. I am a partner at the law firm of Dewey & LeBoeuf LLP, and I have been involved in the mortgage finance business for 30 years.

Thank you for the opportunity to address the challenges in the commercial real estate market from a business and legal standpoint. Rep. Minnick and his team reached out to us in February of this year as the ideas behind CRESA began to mature and take shape. Throughout this process, Mr. Minnick took a grassroots approach to formulating the policy behind the bill and his team has consulted a large, varied array of industry groups, trade groups, practicioners, attorneys and regulators. This problem is large enough in scope that no single piece of legislation will fully create a market rebound; there is no silver bullet. However, I believe the bill we're discussing today is a pragmatic, workable solution which will positively impact as many market participants as feasible. For those entities unable to avail themselves of the CRESA program, we anticipate that general improvements in the CRE market attributable to CRESA will have a ripple effect to the entire commercial real estate market at large.

First, I am going to briefly discuss why this bill is both vital and timely to effectively address the CRE crisis. Second, I am going to discuss the problems unique to the small balance CRE and community bank space. Finally, I am going to discuss why the CRESA program will contribute to a much-needed economic recovery in the CRE markets.

1) Existing Government Solutions to Aid the CRE Market have not Succeeded

I see this piece of legislation as a key element to jumpstart the recovery in the commercial real estate market by targeting important issues that have received less press and attention in the recent turbulent years in the credit markets. Importantly, government programs to date have not been able to impact the $1.3 trillion in commercial real estate loans which are coming due or need to be refinanced in the next five years. The most targeted of the past programs with regard to commercial real estate was the TALF CMBS program. This program, which expired on June 30, 2010, provided TALF loans only for "AAA" rated CMBS securities, and the loans were only for five years. Less thank $15 billion in TALF loans were requested for CMBS, and almost all of that was used for the "legacy CMBS" program for existing CMBS, and not involving new loans. Another program aimed at commercial real estate, the "Legacy Loans PPIP" ("PPIP" for Public-Private Investment Program) was announced in March 2009 and essentially abandoned three months later. The government's SBA programs are not large enough to handle this problem and have a maximum size that will not cover the bulk of today's CRE issues.

The SBLF which passed the House at the end of June provides incentives for banks to resume small business lending; the Senate is currently in the process of considering the SBLF, which passed the House on June 21st. Through the introduction of the SBLF bill, the Administration has sent a loud message that the forecast for small business and small business lending remains bleak and requires intervention. The SBLF provides for direct capital injections into community banks, and while it may prove to be a useful tool to create more small business lending than exists at present, we think a broader push which will rebuild the pieces of the securitization engines gradually and

prudently, in a scalable and appropriate fashion, is exactly what the current regulatory and legislative environment needs.

2) Community Banks and Small Business are at the Epicenter of the CRE Problem

Those community banks with $10 billion dollars or less in assets on their balance sheets are the financial institutions who have carried so many of the defaulted commercial real estate loans on their books. As community banks are a primary source of providing loans to small businesses, it is no surprise that small businesses across the country have been suffering. Many of these loans are small-balance commercial real estate loans. Put another way, much small business lending in this country takes the form of commercial real estate lending.

Community Banks are being pushed by their regulators to get CRE loans off their balance sheets; those banks were so heavily concentrated in certain CRE loans in the first place because those were the only products available and/or affordable to them, when competing with larger financial institutions, both larger banks as well as the GSEs. The smaller banks in this country have found themselves in a catch-22 in that regard, and have stopped making loans to small businesses and other important, job-creating sectors of our economy – without those loans to keep the economy moving, the downturn will be difficult to turn around in the near future. It is worth noting that time, however, is of the essence. If the credit market does not begin to function more efficiently, many CRE assets could drop in value as much as 70% by 2011, from 2007 levels. Additionally, as of today, many market players are purchasing CRE assets, in cash, at 20-40% of replacement value.

The current state of community banks boils down to the weekly FDIC announcements regarding closures and banks under watch. In many cases, the underlying problems at these banks are rooted in commercial real estate. As losses from bank closures have been rolling to the FDIC's deposit insurance fund, it is important to note that the government, via the deposit insurance fund, is already shouldering this mounting burden. As the FDIC's resolution authority only activates upon a bank seizure, we believe a more proactive measure is required, since if the problem can be addressed earlier – before the bank is seized – it can probably be addressed more effectively, and at a lower cost. The FDIC was not designed to handle the situation we are now facing – a lack of liquidity in the credit markets. However, unlike the FDIC, the Treasury and other arms of the government and legislative bodies are better suited to draw a line in the sand and to implement a new vehicle to stop the vicious cycle of frozen credit, bank failures, job losses and devaluation of CRE which the nation has been facing.

3) Utilizing Securitization to Stabilize the Value of CRE

I have worked in the securitization markets for over 20 years and I can attest that there is no more powerful and elegant tool in the capital markets to make consumer finance more affordable, create bonds for different risk appetites, and create a lucrative, steady payment stream for issuers and sponsors of asset-backed securities and purchasers of bonds backed by those securities. Although many have pointed their fingers at securitization during the subprime crisis and related credit meltdown, the financing techniques of securitization have continued to prove themselves to be a superior means of financing consumer loans and leases, across many asset classes, in the capital markets,

and this observation has been made repeatedly by Chairman Bernanke, Secretary Geithner and Chairman Bair.

Unlike the SBLF, the power of the Treasury's bond guarantee under CRESA takes on the problems of the CRE market from a different tack. CRESA attempts to cast a wider net than the SBLF by utilizing a Treasury guarantee which can be used by all originators, although 50 percent of the program's capacity will be reserved for community banks. SBLF provides for direct capital injections, and only at community banks. Being a guarantor on the principal and interest of bonds is a lucrative business; under CRESA the Treasury will in all likelihood bring profits to the government without any cost to the taxpayers, and create liquidity in a troubled sector of the market in the interim (as an intended consequence).

CRESA is designed to restore liquidity and prudent leverage in the capital markets. Values of commercial real estate will not return to the highs before the boom, the Bill does not seek to accomplish what the market could not or would not be able to support in a functioning credit market scheme. Rather, CRESA tries to stop the devaluation of CRE values and return the value of those underlying assets to the levels (or a portion of the levels) at which those loans should be, if the economy and the market were functioning correctly and more efficiently. Once liquidity is introduced, banks (both small and large) will be able to re-commence prudent lending practices. The regulators will no longer require those banks to de-lever their balance sheets, thus creating more space for lending to small businesses and those institutions looking for a loan to invest in commercial real estate. With those changes, the value of commercial real estate will begin to rise from its currently depressed state. Once the current cycle of

artificially depressed CRE values and frozen lending begins to crack, the market will have the requisite liquidity and momentum to begin to self-correct and slowly rebuild the pieces of the CRE market. At that juncture, which we hope will be accomplished shortly after the implementation of CRESA, the government guarantee will not be utilized and the private market will be able to step into the CRE space and begin to revive CMBS transactions and the commercial real estate market overall.

Conclusion

Thank you for the opportunity to present these views regarding the Commercial Real Estate Stabilization Act. I look forward to working with you and the Committee further to assist the implementation of this key piece of legislation.

TESTIMONY OF

THOMAS B. GRONSTAL

IOWA SUPERINTENDENT OF BANKING

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES AND INCREASING JOB GROWTH"

Before the

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

July 29, 2010, 10:00 a.m.

Room 2128 Rayburn House Office Building

Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Tom Gronstal, and I serve as the Superintendent of Banking for the State of Iowa. In addition, I am the Chairman of the Conference of State Bank Supervisors (CSBS). It is my pleasure to testify before you today on behalf of CSBS.

CSBS is the nationwide organization for state bank regulation, representing the bank regulators of the 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands. State authorities supervise approximately 6,000 state-chartered insured depository institutions, the vast majority of which are community banks. For more than a century, CSBS has given state supervisors a national forum to coordinate supervision of their regulated entities, develop regulatory policy, provide training to state officials, and represent state officials before Congress and the federal financial regulatory agencies.

Today's hearing and Representative Minnick's legislation come at a crucial time for community banks and their local economies, as bank balance sheets continue to be challenged by commercial real estate (CRE) loans and the commercial real estate market continues to experience weaknesses. We appreciate the time that the Committee and that Representative Minnick, in particular, have devoted to exploring means for stabilizing the CRE market and overcoming challenges that community banks continue to face in serving this market.

Challenges Facing the Community Banking System

The weakening of the U.S. economy has created a difficult environment for banks of all sizes. Banks are a product of the economy in which they operate and will reflect the economic conditions of those areas. In other words, if the local or national economy is

struggling, the banks operating in and serving those areas will also struggle. While the financial system appears to have been stabilized, banks will need time to restore the health of their balance sheets as the economy struggles to improve.

The current economic environment has created a great deal of uncertainty in the value of commercial property and the predictability of cash flows. This uncertainty creates a challenging environment for investors and businesses, causing them to restrain capital investments and plans for expansion. For lenders, it becomes very difficult to ensure collateral protection and repayment ability for both investor and owner-occupied properties.

These issues are having a significant impact on the commercial real estate market, affecting the performance of existing loans, valuations on bank balance sheets, and the availability of credit. Therefore, in October 2009 CSBS joined the federal financial regulators in issuing guidance for examiners and institutions to utilize when institutions engage in CRE loan workouts. The regulators recognize that financial institutions face significant challenges when working with CRE borrowers that are experiencing diminished operating cash flows, depreciated collateral values, or prolonged sales and rental absorption periods. While CRE borrowers may experience deterioration in their financial condition, many continue to be creditworthy customers who have the willingness and capacity to repay their debts. In such cases, the regulators have found that prudent CRE loan workouts are often in the best interest of the financial institution and the borrower. The guidance directs examiners to take a balanced approach in assessing the adequacy of an institution's risk management practices for loan workout activity.

Based on an informal survey of my colleagues from around the country, we are beginning to see some signs of stability in loan performance and collateral values. While

the value of commercial real estate continues to decline, a significant number of states are beginning to see stabilizing CRE values. The story concerning the performance of CRE loans is a similar one. My colleagues across the states have indicated they are witnessing moderate declines or stabilization in CRE loan performance. Banks are having more success in restructuring poorly performing CRE loans across the states. While many aspects of the CRE markets seem to be stabilizing, my colleagues have indicated that general demand for CRE loans is lagging and banks' interest in funding new CRE loans is still low. As regulators and policymakers, we must recognize that any economic recovery will be uneven. Some regions of the nation, portions of the banking industry and some financial services markets continue to face significant challenges, despite signs of recovery in other areas.

In Iowa, the number of institutions with considerable CRE concentrations has declined over the past three years. In general, CRE loan values have diminished in recent years, but not significantly. This may be a direct result of the fact that Iowa did not experience substantial inflation in the CRE markets in the years leading up to the financial crisis. In addition, public demand for CRE loans is greatly diminished and there is very little new development taking place in the state. This has caused employment in the construction sectors to fall notably in the past two or three years.

The regulatory guidance provided critical support for prudent restructuring of problem credits. Given where we are in the current economic cycle, we believe Congress can play an important role in the CRE market by providing a federal guarantee for prudently underwritten loans. This should help to encourage lending and enhance stability in the marketplace.

The Commercial Real Estate Stabilization Act (CRESA)

As such, CSBS applauds Representative Minnick for his efforts to support community banks and stabilize the CRE market through CRESA. CSBS supports the objectives of CRESA, its focus on small and mid-size institutions and its approach of leveraging a government guarantee to incent private lending and investment activity. Federal guarantees have been effectively used to support bank lending to small businesses and farmers. This can be structured to be a measured risk to support private investment and lending to further public policy and economic objectives.

Further, CRESA's structure contemplates conservative lending by community banks and other institutions with the expertise and experience to engage in successful commercial real estate lending. Additionally, the program's use of a government guarantee to attract and encourage private market activity increases the likelihood of broader market benefits. CRESA contemplates providing guarantees of conservative and prudent CRE lending activity to protect taxpayers from unnecessary risk. Ultimately, implementation of CRESA could provide fuel for market stability and remove uncertainty among market participants, thereby far outweighing the cost or risk of the program by stimulating the CRE market and economic growth.

In terms of the program's structure and oversight, we propose that state bank regulators must be represented on the program's Oversight Board. Given CRESA's stated focus on smaller institutions, we think it important that state bank regulators—as prudential regulators of a majority of smaller institutions and as regulators who are more in touch with local market and credit needs—be a part of CRESA oversight. The required consultation among the federal banking regulators and with state bank regulators on regulatory accounting issues is an important step in this direction and provides a basis for a

more robust role for state regulators. State regulators oversee the vast majority of banks that will be impacted by CRESA and must have a more significant role in the program's administration.

Also, the application process for CRESA should be clear and streamlined to encourage institutions to apply and to make the program as efficient as possible. As we saw with the Troubled Asset Relief Program (TARP), the Secretary of the Treasury should not be vested with sole responsibility for reviewing and ultimately approving applications. An applicant institution's primary federal—and, where appropriate, state—prudential regulator should be part of the application review and approval. This clarity and efficiency will maximize CRESA's usage and success.

One challenge banks will face in participating in the program is capital. Credit losses have strained capital positions as banks seek to work with borrowers and restructure problem loans. While it does not include a capital component, CRESA, along with initiatives such as the Small Business Lending Fund which this Committee and the House of Representatives recently approved, offer the prospect of encouraging lending and stimulating small business stability and growth.

Management of Concentrations

As the Committee contemplates the appropriate measures to prudently support commercial real estate lending, I believe it is important to address the concerns regarding increased levels of concentrations in this sector in the run-up to the financial crisis. Loan concentrations are commonplace for community banks. Community banks reflect the markets and economy they serve. Commercial real estate loans, in particular, require a high level of touch which is uniquely suited for community banks. From public policy and economic development standpoints, it is appropriate for community banks to do this type

of lending, provided they have the required expertise to underwrite and manage these exposures.

However, given the very real challenges facing the industry, there are lessons we must learn from this recession and how it impacted the banking industry. The industry must find more effective strategies for managing risk to ensure sufficient capital through the economic cycle. As regulators, we are reminded of the importance for proactive and early intervention when risks are not adequately identified or managed. We need to work with the industry to determine the acceptable parameters of risk and the capital necessary for support of that risk. From a public policy perspective, we should be cautious of legislative or regulatory approaches which seek to place arbitrary limits on concentrations. This will surely have a significant impact on our economy and may serve to destroy the community banking system. We should focus our efforts on improved risk management, ensuring a bank's ability to remain sufficiently capitalized through the economic cycle.

Conclusion

CSBS remains a fierce supporter of the nation's dual-banking system. This system provides a structure which supports community banking. We commend the Congress for re-affirming the dual banking system in the *Dodd-Frank Wall Street Reform and Consumer Protection Act.* We believe Representative Minnick's proposal is a re-affirmation of the dual-banking system and the vital role community banks play in our national economy. Ultimately, our nation's leaders must seek to create a holistic approach to stabilize all banking industry participants, not just those located on Wall Street. Government efforts must be undertaken with the stated objectives of stabilizing not only the national economy, but local economies, as well. Only through preserving a diverse financial industry and stimulating local economies will we ultimately enjoy comprehensive

and sustainable economic recovery. My fellow state regulators and I stand ready to work with our federal counterparts and members of Congress to do just that. I appreciate the opportunity to testify before you today and look forward to answering any questions you may have.

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HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE OF FINANCIAL SERVICES

ENTITLED

"ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES AND INCREASING JOB GROWTH"

WRITTEN TESTIMONY OF

JAMES L. HELSEL, JR., CCIM, SIOR, CPM, CRE, FRICS

2010 TREASURER, NATIONAL ASSOCIATION OF REALTORS®

JULY 29, 2010

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Chairman Frank, Ranking Member Bachus, and Members of the U.S. House Financial Services Committee, thank you for inviting me to testify today on "Alternatives for Promoting Liquidity in the Commercial Real Estate Markets, Supporting Small Businesses and Increasing Job Growth." My name is Jim Helsel and I am the President of Helsel, Incorporated, Realtors® in Camp Hill, Pennsylvania. I have been involved in real estate for 35 years and currently serve as the 2010 Treasurer of the National Association of REALTORS® (NAR).

I am here to testify on behalf of more than 1.1 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry. Members belong to one or more of 1,400 local associations/boards and 54 state and territory associations of REALTORS®.

Having a sound and well functioning commercial and multifamily real estate sector is critical to our country's economic growth and development, and to millions of U.S. businesses of all sizes that provide local communities with jobs and services. It is estimated that the commercial real estate sector supports more than 9 million jobs and generates billions of dollars in federal, state and local tax revenue. Nonetheless, the overall economic downturn and crisis in the broader financial markets is directly impacting not only the fundamentals of commercial real estate finance, but also the outlook for recovery. And while the commercial and multifamily real estate markets play a vital role in the economy, these markets are now experiencing the worst liquidity challenge since the early 1990's.

Many of us in the $6.5 trillion commercial real estate industry have been warning for some time that the liquidity crisis facing our industry has the potential to wreak havoc on the broader economy. In fact, an apt description for the situation is that commercial real estate is the —next shoe to drop. The collapse of the nation's housing market had and continues to have a huge impact on the entire global financial system. Likewise, it is important to recognize the economic ramifications of a widespread collapse in the commercial real estate markets.

Moody's has proposed that "Losses on commercial real estate loans could top $150 billion by the end of 2011." In fact, as of the first quarter of this year, delinquency rates in the CMBS market were up to 7.24%. By year end, delinquency rates on loans for commercial properties could rise to between 9% and 14%, according to Jefferies & Co., as consumer spending and confidence continues to be low. Furthermore, commercial property values have fallen 43% across the board from their peak in 2007, and more than 33% from 2008, according to Moody's. Moody's also estimates that commercial property values could fall between 44% and 55% from 2007 prices. A June survey of our commercial members revealed that more than 46% of them had not completed a single commercial sales transaction in the first quarter of 2010. NAR's economic research suggests that vacancy rates in commercial sectors will not stabilize until early 2011. Billions of dollars in U.S. mortgages are now underwater, meaning the loan balance is higher than the value of the underlying asset. In fact, half of all commercial real estate mortgages will be underwater by the end of 2010,

according to Elizabeth Warren, chairwoman of the Congressional Oversight Panel.[1] Furthermore, loan originations are down 87.2% in the first quarter of 2010, compared with the peak in 2007.[2]

A crisis is looming in the commercial real estate market due to a confluence of issues that include: (1) economic conditions, especially high unemployment; (2) weakening commercial property fundamentals; (3) declining commercial property sales volume and price; (4) slowing commercial property lending; and, (5) increasing commercial loan delinquencies. These challenges, paired with $1.4 trillion of anticipated commercial mortgages' maturities through 2014, create a challenging commercial real estate finance environment.

Combating the Crisis

NAR believes that a number of solutions will be needed to lessen this crisis. Since all properties are different, we believe different approaches will be necessary. When looking at this problem, we think of commercial properties as following into three categories: (1) properties that are simply not sustainable; (2) properties that are performing, current, and can support their debt – but may have difficultly refinancing because their value is lower than their debt; and (3) properties that are viable long-term but need immediate help with loan modifications or refinancing assistance. There are some properties that simply cannot be saved, as described in category one. However, the other two property types – which are viable long-term, can be saved with a variety of tools. It is critical these steps are taken to prevent a total collapse of commercial markets and a corresponding downturn in our economy.

The Commercial Real Estate Stabilization Act

NAR applauds the intended goals of the "Commercial Real Estate Stabilization Act of 2010" (H.R. 5816), introduced by Representative Minnick (D-ID). As the current commercial real estate liquidity crisis is exacerbated by the current economic downturn, Congress should consider legislation aimed at stabilizing our nation's fragile financial and commercial real estate sectors. We strongly support the objectives to stabilize commercial mortgage markets and help to clear the inventory of troubled properties.

Representative Minnick's proposal to create a temporary program to guarantee commercial loans could jump-start lending and help to rebuild a private commercial mortgage market. As delinquencies continue to climb, and owners find no avenues to refinance, such a proposal could help limit further defaults, which are currently dragging down our economy. We look forward to working with Representative Minnick and the Committee to further review this proposal and the impacts it will have on our fragile markets.

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[1] CNBC.com, "Half of Commercial Mortgage to Be Underwater: Warren", March 29, 2010.

[2] Mortgage Bankers Association "Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations – 2010.Q1.

Other Legislative and Regulatory Proposals

While NAR supports a variety of proposals to improve commercial real estate markets, there are specific proposals that have been discussed a length by Congress, and could have an immediate impact if enacted. These proposals include: (1) increasing the cap on credit union member business lending (MBL), (2) passage of the Small Business Lending Fund Act, and (3) changes to the Small Business Administration's (SBA) loans. Moreover, we believe there are additional solutions that could help mitigate the commercial credit crisis, which include term extensions for performing commercial mortgages and accelerated depreciation.

Credit Unions

The biggest problem in commercial real estate and small business markets is lack of available capital. Two members of this Committee have introduced legislation that will take steps to address this problem. H.R. 3380, introduced by Rep. Kanjorski (D-PA) and Royce (R-CA) will increase the cap on credit union lending to 25%.

Commercial banks account for $1.5 trillion or 45 % of outstanding commercial real estate debt.[3] Due to the slumping economy and falling commercial real estate values, many commercial banks have tightened their credit standards and reduced their loan volumes. For example, lending was down 7.82% among the ten largest U.S. banks in 2009. While these large banks, with assets over $10 billion, hold over half of commercial banks' total commercial real estate whole loans, their actual exposure (total commercial real estate loans/total Tier 1 capital) is relatively low when compared with small and mid-size financial institutions.[4] Tier 1 capital is the amount of money banks have on hand to cover any loan losses.

According to the Congressional Oversight Panel (Oversight Panel) report issued last February, banks with assets of $1 billion to $10 billion have the highest commercial real estate exposure, followed by those with assets of $100 million to $1 billion. These two asset groups have an average commercial real estate exposure of 347% and 345% more than their available Tier 1 capital reserves, respectively. Unlike large banking institutions, small and midsize banks are more vulnerable to commercial real estate trends because they do not have credit card services or investment banking operations to offset significant commercial real estate losses.

The Oversight Panel report also identified smaller regional and community banks with "substantial" commercial real estate exposure account for almost half of the small business loans issued across the country. Of the roughly 8,100 U.S. banks, some 2,988 small institutions have "problematic" exposure to commercial real estate loans. In other words, their level of commercial real estate loans

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[3] Congressional Oversight Panel, *February Oversight Report: Commercial Real Estate Losses and the Risk to Financial Stability*, (February 10, 2010) (online at http://cop.senate.gov/documents/cop-021110-report.pdf) (hereinafter "Oversight Panel").

[4] Oversight Panel

is at least 300% of total capital or their construction and land loans exceed 100% of total capital. This exposure amongst small regional and community banks has caused a significant decrease in credit available to the small business community, which has slowed down the national economic recovery.

A decrease in small business loans could also elevate problems within the commercial real estate industry by further reducing cash flows and raising vacancy rates. Additionally, we are concerned that lending will be further constrained as more banks continue to fail and seized or taken over by regulators. Since January 2008, 269 banks and savings institutions have been seized by regulators, including 104 so far this year, according to the Federal Deposit Insurance Corporation (FDIC).

During previous crisis' consumers and businesses have relied on credit unions to fill in the gaps where banks cannot serve them. Credit unions have been providing business loans for more than 100 years. But today they are hampered by a member business lending (MBL) cap of 12.25% of total assets. Many commercial REALTORS® have reported having strong, long-lasting relationships with credit unions, which could help them refinance and sustain their properties – but simply cannot due to the lending cap. This cap was instituted in 1998 for no discernable rationale. There is certainly reason today to raise it. More than half of the outstanding business loans held by credit unions have been extended by those approaching or at the cap. That means that credit unions with experience in handling these loans are unable to continue to help get us out of this crisis. Additionally, the Credit Union National Association (CUNA) estimates that, if H.R. 3380 were signed into law, credit unions could extend up to $10 billion in additional business loans to their members, helping them create 108,000 jobs.

H.R. 3380 now has the expressed support of 124 Members of the House of Representatives. This legislation will increase liquidity without costing the federal government a dime or risking taxpayer resources. We urge this Committee to move this bill before the end of the 111th Congress.

Furthermore, we also support the Administration's proposal to increase the cap on credit union MBL lending. Unlike H.R. 3380, the Administration's proposal would raise the current 12.25% business lending cap to 27.5% for well-capitalized credit unions. We do, however, oppose the Administration's proposal to require credit unions to have at least 5 years of MBL experience in order to qualify for the higher limit. This would unfairly prevent credit unions that have proven to be well-capitalized and ready to lend to the small business community from participation.

While raising the arbitrary credit union MBL cap is not the "silver bullet" solution to the commercial real estate industry's financial woes, it would be an important step in restoring the flow of credit to the commercial real estate industry and subsequently help our nation's economic recovery.

Small Business Lending Fund Act

NAR applauds the leadership of Chairman Frank (D-MA) in passing H.R. 5297, the "Small Business Lending Fund Act of 2010." This bill would authorize the U.S. Treasury to lend up to $30 billion to interested community banks, in order to expand access to credit for small businesses. According to the Independent Community Bankers of America (ICBA), the $30 billion in capital provided in this

legislation could help community banks provide as much as $300 billion in additional small business lending.

Under the program's mandates, loans issued to participating banks would be required to be repaid, with interest, over a 10-year period. More notably, the bill contains lending provisions that help ensure community banks have both the incentive and capacity to increase total loans to small businesses by decreasing the dividend or interest rate cost on the capital investment as lending grows. Specifically, this performance-based program would adjust the initial 5 percent interest rate for voluntarily participating lenders relative to the amount of their small business lending activity. For example, banks that increase such lending by 10 percent or more would pay an interest of 1 percent.

Conversely, lending institutions that do not increase their small business lending within the first two years of the program would be required to pay a 7 percent interest rate thereafter. As an added safeguard to ensure that participating banks will use the loans received from the federal government to leverage new loans to small businesses and repay those loans to the federal government in a timely manner, at the end of 4.5 year term, the annual interest rate for all borrowers would be fixed at 9 percent.

We also support the efforts of Representative Minnick (D-ID), who successfully added an amendment to that bill, which would broaden eligibility for the program by including non-owner occupied commercial real estate in addition to owner-occupied commercial real estate loans. More than $1.4 trillion in commercial real estate loans will come due by 2014, and roughly 65% of these deals will have trouble getting financing. Depressed conditions in the small business community continue to negatively affect the commercial real estate industry, which threatens our nation's economic recovery.

Additionally, we applaud the efforts of Representatives Miller (D-NC) and Perlmutter (D-CO), who helped pass amendments that would provide additional credit to the commercial real estate industry. Representative Miller's amendment further expands the program's definition of small business lending to include loans made to small businesses for the purpose of acquiring, constructing, or improving industrial, commercial, residential, or farm buildings. Representative Perlmutter's amendment allows small banks to amortize commercial real estate loan losses or write-downs over 10 years, freeing up more capital for these institutions to lend to small businesses.

As the Senate considers this bill, we support the inclusion of provisions to raise the cap on credit union MBL. We also support several new tax provisions that they are currently debating. REALTORS® are generally self-employed individuals who are also investors in real estate and/or advisors to those who invest in real estate. Two tax provisions, bonus depreciation and new expensing rules, would enhance the real estate business and provide fairness.

Bonus Depreciation

The existing rule allowing the expensing of otherwise depreciable assets would be, for the first time, expanded to include the category of real estate assets known as "leasehold improvements." Allowing small businesses to expense these improvements will create jobs and improve property values. The

provision is a substantial incentive for small investors who wish to upgrade their real estate properties.

Expensing Rules

A second valuable tax provision would put the self-employed on a level playing field with other businesses. Under current law, an employer may deduct from both its income tax base and its payroll tax base the cost of health insurance premiums made on behalf of employees. By contrast, self-employed individuals may deduct health insurance premiums for themselves and their families for income tax purposes, but not for payroll tax purposes. The new provision provides a temporary rule that will permit the self-employed to deduct health insurance premiums when calculating self-employment taxes. This new provision creates equity between employers and the self-employed.

Small Business Administration (SBA) Loan Changes

Improving access to capital for small businesses is widely acknowledged as a critical part of growing the American economy. According to recent reports, banks reduced the amount of money extended to small businesses by $15.7 billion between September 2008 and September 2009.[5] As banks continue to pare back small business lending, the Small Business Administration (SBA) can be a useful tool for facilitating access to the loans small businesses need.

Unfortunately, however, it seems many small businesses are having trouble getting SBA loans to grow and improve their operations. REALTORS®, who are independent contractors and entrepreneurs, are a part of this group. Many brokers and agents are small businesses that struggle to find capital for day to day operating expenses, debt service, capital expenditures, and funding for expansion. Agents specializing in commercial real estate could see particular benefits from improved SBA lending, as small businesses use these loans to purchase and lease commercial properties.

NAR commends the SBA's decision to include real estate professionals as eligible candidates for SBA loans, but across the country, REALTORS® have reported problems getting access to SBA loans. Applications can be 100 pages long; documentation is required that most small businesses don't keep; some lenders are uninformed on who is eligible for the loans. Even after these obstacles are surmounted, SBA lenders are often still reluctant to make the loans.

Like everyone else, real estate practitioners have been feeling the credit pinch. In response, the SBA has temporarily eliminated fees that impede loan applications and ultimately the loans themselves as well as increased guarantees up to 90% on some loans. While this is an important step in restoring liquidity to the small business sector, raising loan limits for both SBA 7(a) and 504 loans will provide further relief. Currently, SBA 7(a) loans are available up to $2 million and SBA 504 loans are available up to $4 million, depending on the purpose of the loan. Raising these loan limits will provide another lending vehicle for commercial property owners in a credit market that remains tightly constrained. Furthermore, permitting SBA 504 loans to be used for refinancing of

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[5] Appelbaum, Binyamin and Ylan Mui. "Lack of Customers, Assets Stunting Growth for Small Business." *The Washington Post* February 2010: A12.

performing commercial properties can be another useful tool to help address the liquidity crisis facing the commercial real estate industry. We urge Congress to consider these important modifications to SBA loans. We also support the inclusion of these provisions in the Small Business Lending Fund legislation currently being considered by the U.S. Senate. Finally, we urge Congress to provide appropriations for these measures that will match small business demand.

The availability of credit to small businesses has a strong impact on commercial properties. According to the Oversight Report, large banks with the highest exposure to commercial real estate loans account for nearly 40% of all small business loans. As small business credit becomes even less available, commercial markets will continue to suffer. Many small businesses take out short term loans to cover inventory or payroll expenses until sales or other revenue is generated. However, many of these borrowers find themselves unable to obtain credit in the last year. According to the National Federation of Independent Businesses, the percentage of small business owners holding a business loan or credit line each fell almost 20 percent in the last year. This makes it harder for them to pay rent on their leased space, or causes them to abandon their business, creating high vacancy rates in commercial space, which can decrease the value of the properties, adding to the crisis.

Additional Solutions

NAR believes a number of additional steps could be taken to prevent a collapse of the commercial mortgage market.

Term Extensions

For properties that can support their current debt, a simple loan extension makes perfect sense. As most commercial loans are short term, these loans refinance frequently. If instead of requiring a refinance at the end of a loan term (and having to deal with the equity gap), lenders could be encouraged to extend the term of the current loan. Currently lenders are not offering extensions because they are wary of oversight and regulatory concerns. Federal guidance encouraging these types of extensions for appropriate properties could be a helpful tool.

Accelerated Depreciation

Improved cash flow for investors/owners of commercial real estate would help to fend off some of the challenges the market faces. The most effective means of improving the cash flow on real property is to provide more generous depreciation allowances. We believe that some combination of accelerated depreciation (or shorter recovery periods) and passive loss relief would be significant investor incentives. Proposals related to depreciation would have the most immediate and beneficial impact on investment incentives and carry great potential for improved cash flow. Improved cash flow can soften some of the coming commercial liquidity crisis, particularly as it affects performing loans that are underwater.

Conclusion

Having a sound and well functioning commercial and multifamily real estate sector is critical to millions of U.S. businesses of all sizes that provide local communities with jobs and services and, consequently, to our country's overall economic growth and stability.

NAR believes it is critical for Congress to act. During the previous commercial market collapse in the 1980s, the Oversight Report states that "roughly 2,300 lending institutions failed and the government was forced to expend $157.5 billion (approximately $280 billion in 2009 dollars) protecting depositors' funds and facilitating the closure or restructuring of these organizations." Given the same report states projects that losses at banks could range as high as $200-300 billion between now and 2011, something must be done.

As always, NAR is at the call of Congress, the financial regulators, and the Administration, to help in the ongoing effort to find solutions to stabilize and ensure recovery of the commercial real estate markets. Such an effort is particularly important given that the commercial real estate sector is a key component to job creation and economic revitalization for the nation as a whole.

Again, we appreciate the Committee holding this hearing and we stand ready to assist in any way in your efforts going forward.

Testimony of Todd Lindsey
July 29, 2010

Thank you for the opportunity to testify today.

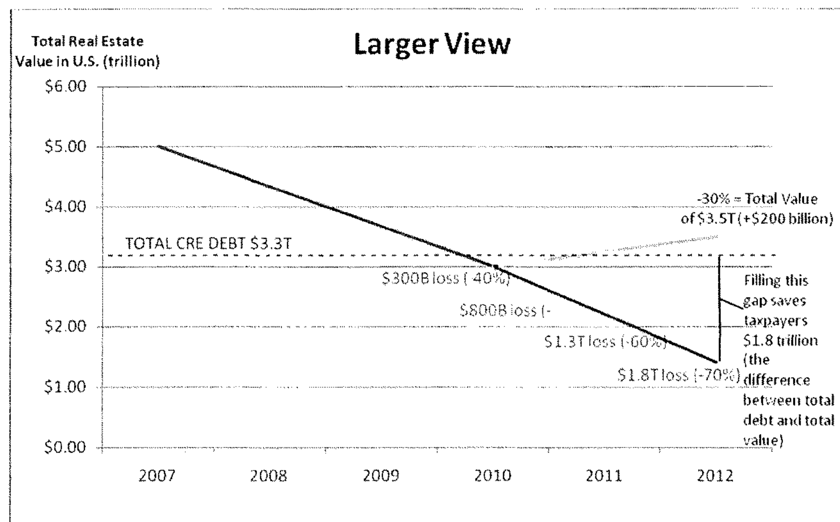
Over the last 15 years, our credit markets have become increasingly reliant on, and structured around securitization. Leading industry experts and government officials, including Secretary Geithner and Chairman Bernanke, have stated that a functioning securitization market is a vital part of our credit market and the economic recovery.

Over the last 24 months, much has been done by the government and private industry to stabilize the credit markets, including a portion of the securitization market. Much has been accomplished and we have, thus far, avoided a complete collapse of the financial system.

The residential real estate, consumer credit, and corporate credit markets have stabilized, in large part, because of successful government programs targeted at those particular markets. The commercial real estate credit market has been largely left behind, and now poses significant risk to the fragile credit system and economic recovery.

In 2007, the value of all US commercial real estate was approximately 5.5 trillion dollars. According to the February 2010 congressional oversight panel report on commercial real estate, values have declined by 40 percent. This decline in value has destroyed over 2 trillion dollars of equity in the last 24 months. Further declines will create greater losses, a majority of which will be absorbed by the banking system and ultimately the taxpayer.

The simplified graph shown below, outlines the significant risks to the economy created by continued deterioration of the commercial real estate market.



It is important to understand that the banking system is capitalized with 1.2 to 1.4 trillion dollars. Real Estate losses of the magnitude demonstrated in this graph would have catastrophic consequences to the US banking system.

It should be pointed out, many commercial real estate transactions today are reflecting reductions of value of 70 percent or greater. The lack of a functioning commercial credit market has been and will continue to be, a major cause of these declines.

In 2007, the commercial real estate securitization market provided 240 billion dollars of funding to the commercial real estate sector. Since that time, the commercial securitization markets have been shut down.

With economic, regulatory, and accounting risks clouding the market, the future of securitization is unclear.

In short, without some sort of government assistance the securitization markets are unlikely to provide any significant credit to the commercial real estate market. Because commercial real estate loans generally do not fully amortize over the loan term, the nation's stock of commercial loans is refinanced on a regular basis. It is estimated that 1.3 trillion dollars of loans will reach maturity in the next 36 months.

A majority of smaller balance commercial real estate loans are on the balance sheets of the nation's community banks, but because of both capital and regulatory constraints, many banks are not in a position to make new loans, or refinancing their existing loans.

The bill we are discussing today is designed to jump-start the private Commercial Mortgage Backed Securities ("CMBS") market. The CMBS market is well known by market participants, and has demonstrated the ability to facilitate the funding of large numbers of loans. Currently, the credit system has neither the functional or capital capacity to fund projected loan volumes.

This bill directs the Treasury to guarantee bonds backed by newly originated commercial real estate loans. The taxpayer will be protected in the following ways:

1. A large guarantee fee will be paid to the Treasury. This fee will be structured to offset the costs and losses of the program and hopefully generate substantial profit to taxpayers.
2. Only new loans underwritten in accordance to guidelines, developed by industry experts, will be included in the program.

3. All properties will be re-appraised at today's market valuations. Making loans at a low point in the real estate cycle has historically been very safe.

This program is not a "silver bullet". It is also not a bailout for financial institutions. It does not artificially increase value of commercial real estate. It is intended to simply support the extension of reasonable credit to the commercial real estate sector.

I look forward to any questions you may have on the market or this program in general. Thank you for your time and attention to this important issue.

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Testimony of

Ernest J. Panasci
Shareholder and Director
Jones & Keller, P.C.

Before the House Committee on Financial Services

Hearing on
H.R. 5816, the Commercial Real Estate Stabilization Act of 2010

July 29, 2010

Mr. Chairman Frank, Ranking Member Bachus, and Members of the Financial Services Committee: Thank you very much for the opportunity to testify at today's hearing on behalf of financial institutions in the United States. My name is Ernie Panasci and I am a Shareholder and Director of Jones & Keller, P.C., a law firm with offices in Denver and Greenwood Village, Colorado. Over the years, I have also been a member of the Board of Directors of several financial institutions.

Jones & Keller is considered a small law firm with approximately 30 attorneys that represents approximately 75 financial institutions throughout the Western Region of the United States. Our financial institutions group consists of approximately 12 attorneys, most of whom devote a substantial portion of their time to representing financial institutions in this region. Personally, I have represented financial institutions since 1981 and I devote in excess of 75% of my time to working with financial institutions. As an attorney in the financial institutions arena, I work closely with management and the boards of directors of these financial institutions. As part of my representation of these financial institutions, I have frequent contact with regulators, including the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Federal Reserve, and State Bank Commissioners in the Western United States. What was once regular interaction with financial institution regulatory agencies has increased, over the past 18 months, to daily interaction with regulators. To say these are trying times for both bankers and regulators is an understatement. The attempt of both bankers and regulators to professionally and accurately perform their duties has at times led to difficult interaction. However, both the regulators and the bankers realize that each has their own job to perform and I believe there is a level of respect between them.

The House of Representatives and the Senate have attempted to deal with these difficult financial times and the Dodd-Frank Wall Street Reform and Consumer Protection Act recently enacted into law by President Obama is evidence of everyone's intent to move this process along. I am here today to discuss H.R. 5816, the Commercial Real Estate Stabilization Act of 2010, and complimentary legislative regulatory proposals that would increase the availability of credit and improve the financial condition of financial institutions. My analysis of this bill leads me to believe it will be a step in the right direction to unclog the commercial real estate lending markets. It is an understatement to state that there is a logjam in providing credit to the commercial real estate market. With increasing capital demands by regulators and the now concrete percentage limitations placed upon the dollar amount of commercial real estate loans pursuant to the commercial real estate lending guidelines, it is extremely difficult, if not impossible, for financial institutions to make new commercial real estate loans. One would only need to read the written enforcement actions posted on the websites of regulatory agencies to realize that there are ever-increasing capital demands being placed upon financial institutions. The old 8 and 10 percent capital guidelines have been replaced by 10 and 12 percent, and in some instances even greater capital requirements. Most financial institutions are having a difficult time in raising equity capital and as such are not able to make new loans because each dollar lent by a financial institution requires 10 cents to 14 cents of additional capital, depending upon the capital requirements imposed upon the institution by its regulator.

The Commercial Real Estate Credit Guaranty Program would enable financial institutions to remove the guaranteed portion of these credits from their CRE portfolio and in certain instances enable them to make additional commercial real estate loans in the future. The program as outlined in the Bill would be a benefit to financial institutions. However, I suggest

that the House consider limiting the maximum guaranteed amount to one institution to approximately 3 percent of its total risk weighted assets as of a certain date and, if possible, increasing the amount of the total guaranteed dollars to some amount in excess of $25 billon. My belief is that the Secretary of the Treasury will find great interest in this program and will be inundated with applications to have commercial real estate credits participate in the program.

In additional to the Commercial Real Estate Credit Guaranty Program, I applaud Congress for its passage of the Dodd-Frank Act. In particular, I believe that Section 616 of the Dodd-Frank Act is very relevant to the proposed Commercial Real Estate Credit Guaranty Program and Small Business Lending Fund Program (H.R. 5297). As you know, Section 616 requires the Federal Reserve, in establishing regulations for capital standards, to make such standards countercyclical. In other words, in times of economic prosperity, the capital standards should be higher and in times of economic stress, the capital standards should be lower. With the combination of a decrease in the capital standards applicable to banks during these economic times and the implementation of amortization provisions of the Small Business Lending Fund Program, overall, banks will be in a much better position to lend to businesses. I encourage the Federal Reserve to act on these countercyclical regulations as soon as possible given the fact that we are still in the middle of an economic crisis.

While I believe the foregoing will provide some relief to financial institution lending and to financial institutions, I cannot stress enough the importance of the implementation of the temporary amortization authority currently provided for in H.R. 5297. As you are aware, Regulation H enacted by the Federal Reserve in the 1980's assisted agricultural banks with the amortization of agricultural loan losses. The FDIC report concerning the banks that participated in this program states that of the 301 banks in the agricultural capital forbearance program, 201

were operating as independent institutions one year after leaving the program; another 35 had been merged without FDIC assistance, and 65 banks failed. As these results indicate, after a period of forbearance, a large majority of the institutions in the program either were able to recover as independent institutions or had sufficient value to be acquired by merger partners without FDIC assistance. Losses of the 65 banks that failed were similar to those of comparable failed banks, a fact suggesting that the period of forbearance did not result in serious deterioration. Of the 65 failed banks in the program, 59 were under $100 million in total assets and had losses of 21 percent of assets. In comparison, 965 banks with assets less than $100 million that were not in the forbearance program and failed during 1986 through 1994 had a 22 percent loss rate. As you can glean from these statistics, the agricultural loan loss amortization program previously implemented in the 1980s did not increase the losses to the insurance fund, but rather reduced such losses.

The combination of increasing capital demands and heightened loan losses due to the economic conditions that the country as a whole has been experiencing have contributed to a decrease in not only commercial real estate loan, but also small business lending. Many bankers now realize that loan portfolio diversification is a necessity and are not able to undertake small business lending due to the aforementioned issues. Enabling eligible institutions to amortize loan losses as outlined in H.R. 5297 will significantly enhance banks ability to increase small business lending because of the positive impact it would have on banks' capital. Full and fair public disclosure is required in H.R. 5297 as was provided under the old Regulation H. In addition, sufficient safeguards are provided in H.R. 5297 in that it specifically provides that the appropriate federal banking agency is to establish regulations defining minimum underwriting standards that must be used for loans made by eligible institutions. Temporary amortization

authority provided for in H.R. 5297 has appropriate safeguards for public disclosure and sound underwriting standards for the future.

Small business lending is essential to the American economy. There is no question that the lending markets were frozen at the time of the unparallel economic crisis that started in 2008 and to a lesser degree continues today. The revitalization of the American economy is tied directly to the availability of credit for small business. I think Congress has made progress in alleviating these conditions through the passage of the Dodd-Frank Act and other legislation. However, I strongly believe that the passage of H.R. 5816 and the inclusion of the temporary amortization authority provided in H.R. 5297 will contribute significantly to increase lending by financial institutions and the recovery of small business in the United States.

Thank you very much for the opportunity to testify at today's hearing. I am pleased to answer any questions the Members of the Committee may have.

Statement of the National Association of Home Builders

Alternatives for Promoting Liquidity in the Commercial Real Estate Markets, Supporting Small Businesses and Increasing Job Growth

**Hearing before the Financial Services Committee
Of the U.S. House of Representatives**

July 29, 2010

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the Financial Services Committee on lending conditions in the home building industry. While there are several signs that the housing market may now be at or near bottom, the acquisition, development and construction (AD&C) lending crisis that has choked off credit for home builders threatens to prolong the current housing and economic downturn. Lack of production credit is placing enormous pressure on home builders' bottom lines and, for many, endangering their ability to survive the economic downturn. Housing was the first sector hit by the current economic crisis and no sustainable recovery can be achieved until the housing industry revives.

The housing sector is an industry made up of mostly small businesses. Over 85 percent of NAHB's builder members reported building fewer than 25 homes per year in both 2008 and 2009. Over 85 percent of them have less than $5 million in annual receipts, and over 95 percent have less than $15 million. In comparison, the U.S. Small Business Administration classifies construction businesses as small if they have average annual receipts under $33.5 million. Thus, the typical home builder easily qualifies as a small business, and these small businesses depend almost entirely upon commercial banks and thrifts for housing production credit. Each year, NAHB's members construct about 80 percent of new housing in America.

This statement addresses the following areas:

1. Current conditions in the housing market and the long term outlook.
2. Acquisition, Development and Construction (AD&C) credit problems.
3. Economic impact of the AD&C credit crunch.
4. Policy solutions for directing credit to small businesses.

Housing Conditions and Outlook

The current housing recession is the worst since World War II. Total housing starts fell 79% from their peak in January 2006 – from 2.3 million starts to a low point of 479,000 starts in April

of 2009. Virtually every housing indicator (starts, permits and sales) reached all time record lows in the first half of 2009. The drop in single family construction alone resulted in more than 3 million lost jobs in construction and the related industries supplying materials and goods to housing construction.

Glimmers of hope, however, suggest that the three-plus-year decline in housing may have stabilized, but momentum and sustained recovery are far from guaranteed. Existing and new home sales appear to have bottomed, but remain well below historical norms.

Unfortunately, a number of housing specific headwinds will continue to buffet any significant housing recovery:

- A large inventory of vacant homes and apartments on the market
- A pipeline of foreclosures feeding the inventory and producing continuous downward price pressures
- Tight mortgage underwriting and low appraisals making it difficult for a willing buyer to complete the sale
- Extremely difficult financing terms and availability for builder AD&C credit

All these data suggest that residential construction is now bouncing along a bottom. NAHB forecasts that housing starts face a long, slow recovery that will take several years. At present, NAHB is forecasting 646,000 total housing starts for 2010 and 991,000 for 2011. By comparison, NAHB believes that 1.8 million annual starts will be required to meet future housing demand.

Builder AD&C Financing Issues

A critical problem facing home builders is the lack of credit for land acquisition, development and residential construction (AD&C). Residential AD&C loans are used to purchase land; develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. Loans extended to builders/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a six-to-18 month period. While interest payments are made during the development and construction period, the principal on the loan is not repaid to the lender until the home or lot is sold. In addition to the collateral represented by the project under construction, builders may also secure this financing through personal guarantees and/or offering other assets as collateral.

We continue to hear from NAHB members that it is extremely difficult, if not impossible to get AD&C loans and builders with outstanding loans are facing mounting challenges. This is a

major impediment to the housing recovery and an increasing threat to the ability of many home builders to survive the economic downturn.

Current AD&C Financing Conditions

Home builders are having extreme difficulty in obtaining credit for viable projects. Builders with outstanding construction and development loans are experiencing intense pressure as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. The credit window seems to have been slammed shut for builders all over the country.

In many instances, the construction projects are solid projects that simply need to be built out for completion. Even builders who are current on their AD&C loan payments are facing bank demands for additional capital. Most builders have no alternative financing sources, and thus those who would otherwise be able to complete and sell their project under the original terms of the loans, are being bankrupted because they lack the additional money the banks suddenly demand. Performing loans are therefore rendered non-performing as a result of these actions.

These trends are supported by NAHB's member surveys of the availability and cost of AD&C credit. Our latest survey shows that conditions continued to deteriorate through the first quarter of 2010:

- Well over half of respondents to this survey have reported that the availability of credit for AD&C loans has worsened every quarter for ten quarters in a row, from the fourth quarter of 2007 through the first quarter of 2010.
- The ten consecutive quarters of continuing decline in loan availability has been true for all types of AD&C loans: land acquisition, land development, single-family construction, and multifamily construction.
- More than three quarters of the respondents who reported that conditions had become even worse in the first quarter of 2010 stated that lenders are simply not making new AD&C loans.

Appraisals are a major contributing factor to the current AD&C credit crisis. Falling appraised values for land and subdivisions under development have led some financial institutions to stop lending to developers and builders, to demand additional equity, and even to call performing loans.

An increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan. AD&C loans are entirely dependent on collateral (the project being financed) for repayment of principal. In other words, sale of the lot or home is required to provide funds to retire the AD&C loan. Most home building companies are small businesses and do not have the capacity to meet significant equity calls. The result is often foreclosure on a loan that had been performing. Such actions can result in a cut-off of loans on other projects a builder is undertaking and can also have severe adverse consequences for other AD&C loans in the bank's portfolio. Foreclosure on such loans is not in the best interest of the lender, builder or the community.

Performing loans that have been extended routinely in the past are now being called. Banks are increasingly refusing to modify AD&C loans or to provide builders more time to complete their projects and pay off these loans. Some lenders are abandoning the construction lending business, without regard to a builder's ongoing projects, and some institutions are auctioning off loans without negotiating with the builder. These actions have increased foreclosures on AD&C projects which in turn have hurt communities by unnecessarily increasing the inventory of unsold or half-completed homes.

Regulatory Concerns

Of concern to NAHB is that lenders often cite regulatory requirements or examiner pressure that banks shrink their AD&C loan portfolios as the reasons for their actions. While the federal bank regulators maintain that they are not encouraging institutions to stop making loans or to indiscriminately liquidate outstanding loans, reports from NAHB members in a number of different geographies suggest that bank examiners in the field are adopting a significantly more aggressive posture. Moreover, some institutions appear to be overhauling and downsizing portfolios independent of regulator/examiner pressure.

In general, the federal banking regulators have been reminding financial institutions to adhere to the December 2006 bank regulatory Guidance on Understanding and Managing Commercial Real Estate (or CRE) Risks. (The CRE category includes residential AD&C loans.) The Guidance instructs financial institutions with "high" CRE concentrations to have both heightened risk management practices and levels of capital that are higher than the regulatory minimums and appropriate to the risk in their CRE lending portfolios. A financial institution is considered to have a high CRE concentration, and thus subject to the Guidance, if it exceeds or is rapidly approaching the following thresholds:

- Total reported loans for construction, land development, and other land represent 100% or more of the institution's total capital; or

- Total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction, land development, and other land represent 300% or more of the institution's total capital.

The guidance emphasized that the 100% and 300% thresholds are not to be considered as limits or caps on bank CRE lending but rather are intended as guideposts for banks and their examiners in determining appropriate loan underwriting and review systems, risk management practices and levels of reserves and capital.

More recently, federal banking regulators have taken note of tighter lending conditions. In November 2008 they issued a joint statement urging banks to lend to creditworthy borrowers. Further, they warned that excessively tight lending standards could exacerbate current market conditions leading to slower economic growth.

Building on the 2008 statement, on October 30, 2009, the regulators issued new guidance on *Prudent Commercial Real Estate Loan Workouts*. The objective of the new guidance is to encourage financial institutions to pursue workouts on troubled CRE loans, a category that includes residential AD&C loans. Their stated intent is to ensure that supervisory policies and actions do not impair the flow of credit to viable borrowers and projects. The statement says that financial institutions that implement prudent CRE workouts will not be subject to criticism for engaging in such efforts and loans should not be subject to adverse classification solely because the value of the underlying collateral has declined.

The policy statement is a positive step in encouraging workouts as a preferred course of action and in directing examiners to make balanced assessments of institutions' workout efforts. The direction provided on allowing institutions to avoid using liquidation values when assessing collateral and on bifurcation of loans should be helpful to builders and developers.

In general, however, the criteria specified for prudent loan workouts will allow institutions fairly limited ability to structure workouts for AD&C borrowers. Since AD&C loans are collateral-dependent with no internal cash flows to service principal and interest, borrowers on these loans will have to demonstrate other sources of loan repayment, provide additional collateral and/or make principal repayments in order to satisfy the criteria for prudent workouts. Many AD&C borrowers are not in a position to meet such requirements. In addition, the higher likelihood of a reclassification of a restructured AD&C loan as a troubled debt restructuring likely will discourage institutions from pursuing workouts on AD&C loans.

The most recent joint statement from the federal banking regulators, released on February 5, encouraged institutions to engage in prudent lending to creditworthy small business. The statement urged banking institutions to focus on the viability of the borrower's business, rather

than the borrower's geographic location or industry sector. The regulators said they are working with the banking industry and supervisory staff to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound small businesses.

While the statements of the banking regulators seem to support a flexible and pragmatic approach to examination of bank AD&C and other lending activities, NAHB has seen no evidence that the problem of extreme regulatory pressures on lenders is abating. We hear daily from builders and bankers who are complaining of excessive actions from bank examiners. In particular, it appears that examiners are treating the loan-to-capital thresholds as hard limits and using those limits to discourage institutions from taking on viable new loans and forcing them to dispose of sound portfolio holdings. Such results leave the impression that bank examiners are not inclined to revise their restrictive approach and are not exhibiting the flexibility necessary to facilitate reasonable and prudent lending practices.

Comptroller of the Currency John Dugan said recently that banking agencies plan to issue new tougher standards to rein in CRE lending and are considering hard limits on the amount of these holdings on bank ledgers as well as more stringent underwriting standards and increased capital requirements for CRE loans. While NAHB believes that banks should engage in sound, balanced underwriting standards when considering all types of loans, the pendulum has already swung too far on the restrictive side in the current regulatory climate.

At a time when financial institutions need to be engaged in responsible lending practices to spur job creation and economic growth, establishing overly harsh limitations on construction lending will do just the opposite by further stifling the flow of credit for housing production. With the housing market struggling to regain its footing, regulators need to be issuing more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. Tightening the screws further could have a devastating impact on the housing market and jeopardize the budding economic recovery.

NAHB is anxious to work with Congress and the banking regulators to find a way to get the regulators' positive messages implemented in the field and to prevent the imposition of counterproductive additional restrictions on bank lending.

NAHB Recommendations

Financial institutions should be encouraged to fund viable new projects and to take steps to avoid foreclosure on AD&C loans by accommodating loan modifications and workouts. Regulators should issue more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. While NAHB welcomes the new CRE guidance, the workout criteria is focused on income-producing

properties which will help multifamily builders, but will only provide fairly limited ability to structure workouts for AD&C borrowers. For this policy to be truly effective, more flexibility in workouts for AD&C loans is needed.

In the vast majority of cases, lenders would be better off working with their builder/developer borrowers to modify or extend loans, rather than requiring additional equity or shutting off credit. This is a lesson that has been demonstrated by holders and servicers of home mortgages who now increasingly attempt to work out a mutually beneficial solution with struggling borrowers. The alternative is to incur foreclosure and real estate owned expenses, only to sell the property for cents on the dollar.

The same economic principles apply to banks that hold AD&C loans. Rather than calling loans or taking other damaging actions, banks would be acting in their own best interest by modifying or extending loans for borrowers who are not in default and have projects that are worthy of completion. This would allow borrowers to develop alternative repayment plans, adjust their finances or find other funding sources until they are able to complete and sell their homes.

NAHB urges Congress to direct financial institution regulators to encourage lenders to work with residential construction borrowers who have loans in good standing by providing flexibility on re-appraisals, loan modifications and perhaps forbearance. This would give builders sufficient time to complete projects and sell their inventory. Solutions could include allowing institutions to continue making and holding sound AD&C loans even if they are above the loan-to-capital thresholds and to permit institutions to write down troubled loans over an extended period of up to 10 years.

Economic Impact of the AD&C Credit Crunch

The problems in the housing sector have had a significant impact on the nation's economy. The sharp decline in home building from the 2005 peak – a drop of one million units – has translated into 1.4 million lost jobs for construction workers and the loss of $70 billion in wages.

The housing plunge has also affected industries that provide materials and services to home builders. Over 560,000 jobs have been lost in the manufacturing sector due to the housing decline as makers of products such as lumber, concrete, windows, doors, plumbing, flooring and appliances have slashed their workforce in response to slumping demand. This has produced a loss of $25 billion in wages.

Further, jobs have been lost by lenders, architects, real estate agents, lawyers, support staff and others who provide services to home builders and home buyers. There has been a loss of over

580,000 jobs and $32 billion in wages for these service providers. The total impact of the housing slump has been the loss of over 3 million jobs and $145 billion in wages in all housing-related industries.

The ongoing credit problems for home builders will further inflate these totals. Home builders cannot keep their doors open and provide jobs in their communities if they cannot get credit to build even pre-sold homes. And builders in the middle of viable projects cannot pay subcontractors and other materials and services providers if lenders will not grant routine loan extensions or if banks require payment-in-full before homes can be finished and delivered.

The credit crunch also will cause longer-term economic damage. The development process is lengthy, taking years from the acquisition of land to the completion of homes. With lenders refusing to finance lot development, the pipeline of ready-to-build-on land will drain dry. This will result in a major delay in meeting demand for new homes when consumers return to the marketplace in more significant numbers. In cases where federal permits are also required, expirations of these permits will force builders to start the approval process anew, adding at least several years to the pipeline. The effect will be most severe in markets that have not suffered the boom-bust extremes and would otherwise be poised for more rapid recovery.

NAHB estimates that over the next decade there will be a need for at least 1.7 million additional homes per year. This translates into 5 million jobs and significant economic activity. Without increased AD&C lending, this future demand will not be met, job loss will occur and job creation will suffer.

Policy Solutions for Directing Credit to Small Businesses

Home Builders Ineligible for ARC Loans

The policy initiatives that have been undertaken to address credit problems of small businesses, for the most part, have not addressed the financing disruptions in the home building sector, which, as was noted earlier, is made up largely of small companies. The failure of these efforts to provide any relief to builders seeking financing for housing production stems from the fact that the initiatives generally utilize programs of the Small Business Administration (SBA), which have rules that impede borrowing for residential development and construction. Consequently, small home building companies have not seen any real improvement in financing prospects as a result of recent SBA program changes such as the increase in guarantee levels and elimination of certain loan fees.

A case in point is the SBA's America's Recovery Capital (ARC) Program, established in the American Recovery and Reinvestment Act of 2009 (ARRA). The ARC program guarantees

interest free, deferred payment loans of up to $35,000 from participating lenders to help existing small businesses meet their current obligations. When the ARC program was rolled out in June 2009, NAHB was hopeful that this program would help many of NAHB's members to stay afloat through these tough economic times. Unfortunately, these hopes have been dampened as we received feedback from members who are being told by their bankers and SBA field staff that their businesses are not eligible for this assistance.

SBA's Standard Operating Procedures[1] separate home builders' activities into 1) building of a speculative nature, and 2) building under contract with an identified purchaser. SBA has long held the position that the business of home building is *always* speculative, a conclusion with which NAHB strongly disagrees. During times of strong home sales, many home builders constructed homes ahead of sales in order to have homes available on short notice to satisfy the demands of prospective home buyers. Few home builders have engaged in speculative building since the beginning of the current economic downturn. NAHB believes that home builder eligibility for SBA programs should be determined on a case-by-case basis, based on the nature of each builder's activities and the specifics of a particular building project, rather than excluding all builders through an across-the-board approach.

SBA's characterization of the nature of home builders' activities is greatly oversimplified and imprecise, and is inappropriately preventing small building companies from accessing SBA programs. The continuation of this approach is particularly disturbing in the case of the ARC program, which could provide valuable funding to cover costs that are associated with keeping a small company afloat, such as the need to pay utilities and other overhead necessary to maintain an office or vehicles or to safeguard tools and inventories of materials that are used in the normal course of business. These are the types of expenses that home builders, the vast majority of whom operate small businesses, could successfully carry if ARC loans were readily available.

We urge the committee to encourage the SBA to revisit that way it views home building business activities and to reconsider the eligibility requirements for ARC program loans as well as other SBA programs.

Residential Construction Lending Act – H.R. 5409

With the lack of adequate regulatory relief, and the SBA's inability to address the credit needs of residential development and construction, legislation was recently introduced in the House of Representatives to provide up to $15 billion in targeted loan guarantees for residential construction projects in areas where demand for new construction is strong or growing, but where credit for such projects remains scarce. H.R. 5409, the Residential Construction Lending Act, was introduced on May 26, 2010 by Representatives Brad Miller (D-NC), Carolyn Maloney

[1] Small Business Administration SOP 50 10 5(A), Subpart 2, Chapter 2 (III)(D)(s)(2)(e), page 110

(D-NY), and Joe Baca (D-CA). The Residential Construction Lending Act would establish a new loan guarantee program within the Department of Treasury for lenders who provide AD&C loans to builders with viable projects and a track record of success. The bill would allow the issuance of guarantees only for loans made on competitive terms, and only for projects that already have locally approved development plans. Before extending any guarantee, the bill further requires the Department of Treasury to certify that the project is financially viable and to consider other factors, such as local and regional housing demand and local government support for the project. The bill would limit the amount of federal guarantee to no more than 80 percent of the market value of the project, as determined by the Treasury. NAHB strongly supports this new guarantee program, and believes that it will serve to jump start the building industry by providing evidence to lenders and regulators that residential construction loans can safely be made with proper criteria. While some housing markets contain an existing home overhang, the inventory of new homes is at a 42-year low and demand for new residential construction is strengthening in some markets. It is our belief that this legislation will help lead the nation out of our current economic slump by expanding the flow of credit for the home building industry and the millions of people it employs each year. NAHB commends the sponsors of this legislation for their thoughtful approach to this critical problem for the home building industry and urges to committee to take immediate action on the legislation.

The Commercial Real Estate Stabilization Act – H.R. 5816

NAHB also applauds the efforts of Representative Walt Minnick (D-ID) to address the credit needs of the nation's commercial real estate sector through the introduction of H.R. 5816, which would create a temporary program to guarantee commercial real estate loans. As the House Financial Services Committee continues to debate efforts to support small businesses and increase job growth in this country, NAHB urges continued focus on all legislative proposals that address the severe credit problems facing our industries.

Small Business Lending Fund

Recently, the House of Representatives passed legislation, H.R. 5297, the Small Business lending Fund Act of 2010, that would provide $30 billion in capital to community banks to expand small business lending. NAHB applauds the leadership of Chairman Frank in advancing this legislation in the House. Throughout this debate, NAHB has been actively engaged with this legislation to ensure that the new fund can be used to help ease the severe shortage of AD&C loans for small building firms. NAHB supported the efforts of Representatives Brad Miller (D-NC), Joe Baca (D-CA) and Majority Leader Steny Hoyer (D-MD) to make AD&C loans eligible for this new lending program. This effort led to the passage of an amendment by a vote of 418-3 referencing residential construction lending in the definition of Small Business Lending under the new small business lending fund. NAHB was pleased the full House understood the

importance of restoring health to the housing industry in order to promote the economic recovery of the nation. H.R. 5297 is now being debated by the Senate where NAHB is once again actively encouraging the addition of language allowing for the new fund to address the AD&C credit concerns currently impacting our industry.

Conclusion

Thank you for the opportunity to submit this statement. NAHB stands ready to work constructively with the Committee to find prudent and workable solutions to the small business credit constraints that are currently retarding economic recovery. Please direct any questions on this statement to Scott Meyer at (202)266-8144 or smeyer@nahb.org.

Viewpoint: Give Gulf Banks a Break on Property Appraisals

American Banker | Friday, July 23, 2010

By George LeMaistre Jr.

As workers and businesses affected by the oil leak devastating the northern Gulf of Mexico try to cope with its growing impact, banks located in the affected areas — and those located elsewhere that do business there — have very real interests that they, and their regulators, need to protect.

While many of the losses by banks may result only indirectly from the disaster through its effects on bank customers, there is one entry on banks' balance sheets that is directly affected by what is happening in the Gulf: the value of real property in affected areas that is carried by banks as other real estate owned. Typically, these properties are put on the books at values determined by appraisals conducted at the time they're acquired, and subsequent declines in those values have immediate effects that flow through to an institution's earnings and capital.

If a new appraisal shows that the value of a parcel of OREO has decreased, regulators require that its value on the bank's books be written down to reflect the decrease, and the writedown must be charged against the bank's earnings, which has the further effect of reducing its capital. For more than a few institutions, such writedowns can make the difference between profitability and loss.

Because of the drastic circumstances now affecting the Gulf Coast, the state and federal agencies that regulate insured depository institutions should declare a moratorium, for a period of 18 months, on requiring, solely on the basis of current appraisals, that those institutions write down the values of OREO situated in coastal areas affected by the BP oil leak.

Although similar issues arise from regulators' use of appraised values in assessing the adequacy of banks' loan-loss reserves, the numerous other variables that usually are present in that context put those issues beyond the scope of this discussion.

Since the real estate meltdown, regulators have been vigilant in insisting that banks regularly — not less than annually — obtain new or updated appraisals to bring current the carrying values of their OREO.

One result is that institutions which, because of general market declines, already have taken substantial writedowns on coastal properties, now are being required to take significant additional writedowns on the values of properties in coastal areas of Louisiana, Mississippi and Alabama, and in the Florida Panhandle, at the very time that, until the onset of this crisis, many were beginning to sense the onset of a recovery.

Even if the recent capping of the broken well remains effective until a permanent fix is in place, it is entirely unknown how much longer the oil, tar balls, dispersants and related chemicals and their byproducts will continue to wash ashore on Gulf beaches and invade coastal marshes, estuaries and other adjacent bodies of water and associated ecosystems, with effects of unknown scope and duration on the coastal environment and the people and businesses that depend on it.

Only after the flow of oil has been permanently stopped will authorities be able to concentrate fully on containing and overcoming the contamination. Among the few certainties is that this will be an uneven process, proceeding at different paces in different areas, and will require varying amounts of labor, materials and other human intervention in different areas of the coast, according to the nature of the coastal terrain and numerous other factors, including the type, duration, severity and frequency of the contamination experienced.

Amid such uncertainties, the reliability of current appraisals of real property in coastal areas inevitably is subject to question.

There are widespread anecdotal reports that scheduled closings of real estate transactions in coastal areas now are being suspended or canceled with unprecedented frequency.

An impact assessment compiled by a Gulf Shores, Ala., realty firm reports that the dollar volume of property sales in May and June of 2010 in Gulf Shores and neighboring Orange Beach declined more than 36% below the level of sales in those months a year earlier.

It is neither fair nor reasonable for regulators now to require that banks use appraisals conducted under such circumstances in a way that immediately can further depress the levels of their earnings and capital.

What is needed instead is, first, a chance for marine and environmental scientists, engineers, planning officials, economists and other knowledgeable professionals to more fully understand and assess the magnitude and impact of the contamination, formulate remediation plans and make informed assessments of how long it's likely to take. Second, the economies of the affected areas, including their real estate markets, need to have time to absorb and factor in this information, just as all significant new circumstances — such as the announcement of a new highway or new airport to be built — are incorporated into the functioning of local economies and markets.

Refraining for 18 months from requiring that banks use appraisals to revalue their OREO should provide time for affected real estate markets to at least begin accounting rationally for the effects of the contamination, as opposed to acting on the widespread fear that now seems to characterize those markets.

If property values have not at least stabilized by the end of that period, it likely will mean that genuine declines in value have occurred, and it then would be entirely appropriate that they be reflected in the financial results of banks holding affected properties.

It manifestly would be neither fair nor appropriate, however, for such losses to be imposed on banks at the present stage of the crisis, barely three months after the BP well began polluting the Gulf, and at a time when no certain end to the flow of oil is assured and when, as a result, no clearly discernible path to remediation is evident.

Eighteen months from now, Gulf Coast banks and their regulators will be far better informed, and therefore far better positioned to understand the condition of coastal real estate markets.

Reliable appraisals of real property in those markets should be obtainable by that time, making it appropriate for appraisals then to be used to account for the effects of declining property values on the

levels of bank earnings and capital — but to accord such weight to appraisals under current circumstances is hardly reasonable.

The interests of affected banks, their depositors, their shareholders and the banking public, accordingly would be furthered by regulators' imposition now of an 18-month moratorium on requiring that banks, solely on the basis of current appraisals, write down the values of OREO located in areas affected by the Gulf's contamination.

Forbes.com

Commentary

Rebuilding Main Street, Through Small Business And Banks

Reps. Ed Perlmutter, Steve Kagen and Ron Klein 07.19.10, 4:13 PM ET

All across America small businesses and small banks are being asked to pay for the mistakes of speculators and gamblers on Wall Street. People we represent in Colorado, Wisconsin and Florida believe that's not fair: Responsible parties should clean up their own mess and pay for their own mistakes. After all, small businesses and small banks on Main Street did not cause the recent economic meltdown; speculators in big financial institutions on Wall Street did.

Small businesses need our help now, for they are the real economic engines of our economy. They generate over 50% of our nation's annual gross domestic product and are responsible for nearly two-thirds of all new jobs. We've heard time and again from our small businesses at home that they need access to credit to stock inventory, hire workers and weather the storm so they can innovate and grow and drive our economy forward. But they are at a logjam with small banks, who can't and aren't extending the credit they need.

Federal Reserve Chairman Ben Bernanke recently acknowledged that banks need to lend to small businesses. "Lenders should do all they can to meet the needs of credit-worthy borrowers," he said. "Doing so is good for the borrower, good for the lender and good for our economy."

However, to fix banks facing a tough economy, the Federal Reserve, U.S. Treasury and other banking regulators have only been pursuing three options: 1) force banks to raise new capital; 2) force banks to call in loans and stop lending to credit-worthy small businesses; or 3) force the bank to close altogether. This approach has not been working well on Main Street, where credit remains frozen and jobs are hard to come by.

And so, during these unusual economic conditions, we believe there is a better way forward, a fourth option to get credit moving to small businesses: Allow small banks to amortize, or spread, potential real estate losses over time, giving small banks and the small businesses they serve a foundation to build upon and opportunity to work out their challenges over time--not instantaneously. This option was successful during the farm loan crisis in the 1980s, as was a similar program using "net worth certificates," which, according to Former FDIC Chairman William Isaac, saved the FDIC millions of losses during the 1980s.

The House recently passed the Small Business Lending Act, which included our plan. However, during the passage of our amendment in the House of Representatives, Bernanke, Treasury Secretary Tim Geithner and others raised their concerns that allowing small banks to spread potential real estate losses over time might decrease transparency, and that it might cause small banks to take on more risky investments. We respectfully disagree. Our plan guarantees complete transparency of all accounting transactions by banks and continues to empower federal regulators to provide effective bank oversight.

Our plan allows critical capital levels and prudent regulation to be maintained and for credit to be granted to qualified borrowers. It provides some time for a bank to manage problem loans vs. the current practice of harsh, immediate write-downs that will sink many banks and the businesses that depend on them when both can be saved.

We have confidence in the Main Street entrepreneurs, small businesses and the small banks that serve them, and we also have confidence in the regulators' ability to continue to do their jobs effectively, providing the necessary oversight to keep banks honest.

Small-business owners and small banks on Main Street are not looking for a handout; they are not asking for a bailout or a free deal. They are asking for a fair deal, to be able to compete and work out their difficulties over time, difficulties caused by irresponsible Wall Street speculators.

Our plan will work, and it is the responsible way to help small businesses weather the storm, set the foundation to rebuild Main Street, and create the jobs we need to work our way back to prosperity.

Ed Perlmutter is serving his second term in Congress and represents the Seventh Congressional District of Colorado. He is a member of the House Financial Services Committee. Ron Klein represents the 22nd Congressional District of Florida. He is a member of the House Financial Services Committee. Steve Kagen, M.D., represents Wisconsin's Eighth Congressional District and is a member of the House Agriculture and Transportation and Infrastructure Committees.

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