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COASTAL
federal credit union

August 26, 2015

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria VA 22314

On behalf of Coastal Federal Credit union, thank you for giving us the opportunity to comment on the proposed Member Business Loan/Commercial Lending proposed rule. We are pleased to see the NCUA considering such a proposal, and think that it would provide a great deal of relief to credit unions that participate in commercial lending, especially commercial real estate loans, if modified as suggested below.

Coastal Federal began originating non-recourse commercial real estate loans in 2003 under RegFlex rules, and closed 74 non-recourse loans totaling more than $330 million during the 9 years from 2003 to 2012. Of those loans, $159 million were originated under our National Credit program, and through the twelve years since, Coastal has never experienced a 30-day late payment in that portfolio. The weighted average interest rate of those loans was greater than 6%, making it arguably the best risk/return asset on Coastal's Balance Sheet. Since inception, Coastal has operated its MBL program under extensive Board policies, and with a very experienced staff of professionals. We also implemented a risk-grading system nearly 5 years ago.

Coastal has not been allowed to make a non-recourse loan since the end of 2012, due to the loss of RegFlex and our inability until recently to obtain a waiver from our region. As of December 31, 2014, only 12 of those loans totaling $49 million remain in Coastal's portfolio. During 2013 and 2014 alone, more than $80 million of this portfolio paid in full, primarily as a result of Coastal not being able to offer non-recourse refinancing to the borrowing entities.

It is our opinion that the highest quality credits in the commercial real estate market are non-recourse credits, so it is our belief that by allowing experienced credit unions to re-enter this market in a prudent way, the NCUA will actually be strengthening the safety and soundness of the credit union system overall. For this, we applaud the efforts of this proposed rule. <u>We would encourage the NCUA Board to consider an earlier implementation date for this provision in credit unions that demonstrated the policies and expertise to make and manage these loans.</u>

While non-recourse lending can be very lucrative from a risk/return standpoint if done correctly, we understand that not every credit union has done it correctly in the past, and we agree with the proposed rule's attempt to ensure that credit unions adhere to a set of safety and soundness standards when extending non-recourse credits.

However, two of the proposed rules will not provide the desired effect of regulatory relief because they are too narrowly defined or are beyond anything that is required by other regulators, thereby preventing credit unions from being competitive in the marketplace. These are identified below.

CPA-Prepared or Audited Statements

While there is no question that CPA-prepared financial statements are safer and sounder than non-CPA-prepared statements, a provision requiring them will put credit unions at a serious competitive disadvantage in the market place. Coastal attempted to implement such a requirement earlier this year, and our borrowers simply refused to provide them, saying that none of their other lenders required them. Some borrowers even reported that their CPA had refused to provide prepared statements because "he didn't want lenders to be confused and think that he had audited them."

We contacted three commercial banks that originate commercial loans in our local market – two super regionals and a smaller community bank, two state-chartered and one federally-chartered – and all three informed us that they request CPA-prepared statements from borrowers on loans above a certain size, but they do not require them unless the loan is secured by accounts receivable. On real estate loans, they don't even request them. According to these banks, neither the Comptroller of the Currency, the Federal Reserve, nor the FDIC requires even CPA-prepared, much less CPA-audited, financial statements on any commercial loans.

We request CPA-prepared statements on most loans, but if we don't get them, and we usually don't, we "audit" the borrower-provided statements ourselves by requiring documented verification of all material claims of assets and income. This gives us most of the assurances that we would have with an audited financial statement, and the strength of the collateral and associated cash flows and the other underwriting provisions cover all remaining concerns. We recommend that this language be removed from the commentary regarding underwriting expectations, and credit unions be allowed to determine for themselves what is a safe and sound practice in this regard.

Global Debt Service Analysis

There is no question that disruptions in a borrower's global cash flows can have a severe detrimental effect on loans that are dependent on those cash flows. There is also no question that a detailed global debt service analysis should be performed on every loan that can be so affected.

However, while a global Debt Service Coverage Ratio (DSCR) analysis can help a lender understand the risks that might result from disruptions in a borrower's global cash flows, it does very little to actually mitigate those risks. There is a way to actually remove those risks from a commercial loan, and in our opinion, it should always be used on non-recourse commercial loans.

Coastal requires that the owners of its collateral properties establish a bankruptcy-remote, single asset, special purpose entity (SPE) to own the collateral supporting our loans. In this way, no matter what happens to any other assets that the owners of our collateral buildings possess, it will have no effect on our collateral property. Even in a bankruptcy action involving the building's owner(s), the closest the bankruptcy court can get to our collateral is the ownership interest in the entity itself. The court cannot pull our building or its cash flows into the bankruptcy estate. It costs an owner tens of thousands of dollars to establish this legal entity, but Coastal requires it on every large CRE loan

– with or without recourse. It not only protects Coastal, but also protects the owner(s) of the property from devaluation or other issues related to disruptions in the owner's cash flows on his or her other holdings.

On loans where the collateral properties are housed within a bankruptcy-remote SPE, the risks of disruptions in global cash flows don't exist. Therefore, there is really no need to perform a global debt service coverage analysis on such loans. Additionally, many investors who own large commercial buildings own many of them. One Coastal borrower owned 70 buildings, involving literally hundreds of limited and general partnerships of various kinds. It would be virtually impossible to perform an accurate global cash flow on such an individual, and it would probably take six months to even get close.

We recommend that this provision of the rule be amended to require EITHER (1) a global DSCR analysis or (2) that the subject collateral and its cash flows be housed in a bankruptcy-remote SPE to mitigate the risk of disruptions in the global cash flows of the building owner.

Prepayment Penalties

We feel it is necessary to bring up one issue that was not directly addressed in the Proposed Rule, but which we believe warrants high consideration by the NCUA for regulatory revision. Federally chartered credit unions are prohibited by regulation from having a prepayment penalty on any type of loan. Coastal understands the rationale for prepayment penalties to exist in consumer lending. However, business lending is very different and is most often a longer, more costly process requiring specialized expertise and systems. The investment made in originating and managing a commercial real estate loan, for example, will typically be thousands of dollars in staff time, systems, and third party costs.

If a business member takes out a commercial real estate loan with no prepayment penalty, then refinances or pays off that loan a few months later, the credit union which by regulation, could not charge a prepayment penalty, has not had sufficient time to earn interest and recoup the high costs of making the loan. This results in an economic hardship for the credit union that was strictly caused by regulations. Many state chartered credit unions can charge prepayment penalties, yet federally chartered credit unions cannot. This uneven playing field within our own industry is difficult to understand.

We do understand that NCUA regulations allow for a "cost recovery" clause, which acts similar to a prepayment penalty. In practice, this is rarely, if ever, used. It is confusing to credit unions and certainly to borrowers, versus a prepayment penalty which is standard practice in commercial lending. Frankly, the cost recovery clause does not substitute for even the most simple prepayment penalty.

We suggest that an easy solution to rectify this unintended regulatory burden is to allow loans defined as Member Business Loans under Regulation 723 to be exempt from the prepayment penalty prohibition. We respectfully request that the NCUA consider this important revision to the Proposed Regulation. [701.21(c)(6)]

Final Comments

We are concerned that the principles-based approach will rely in large part on subsequent "Supervisory Guidance" that will be used by examiners to interpret the Final Rule and carry out MBL exams. The industry will have no input on how this guidance is put together and may not understand or interpret the guidance in the same way examiners do. It is imperative for credit unions to fully understand the areas of emphasis and expectations examiners will be focusing on in their work. [Reference: Page 36 of Preamble to Proposed Regulation]

Our final area of concern is that the principles-based approach will require a tremendous amount of judgment by field examiners. NCUA has improved expertise and exam consistency over the past decade, but it will be essential to continue to develop true commercial lending expertise in examiners, as well as ensuring consistency in all credit union examinations.

Again, let me emphasize that we are very supportive of the proposed changes to the regulations, and appreciate the work done by the NCUA in advancing this proposal.

We will be happy to provide any additional information that you need regarding this matter. Thank you for providing us the opportunity to comment on this proposed regulation.

Sincerely,

Chuck Purvis

Chuck Purvis
President/CEO