

**Statement of Cynthia Shelton, CCIM, CRE
on behalf of the REALTORS[®] Commercial Alliance**

**Hearing before the House Government Reform
Subcommittee on Government Management, Finance and Accountability
on
Office of the Comptroller of the Currency's Decisions
to Allow National Banks to Engage in Real Estate Development,
Ownership and Merchant Banking
September 27, 2006**

Thank you Chairman Platts, Ranking Member Towns and members of the Subcommittee for inviting me to testify today on the impact of the Office of the Comptroller of the Currency's (OCC) rulings expanding the authority of banks to develop real estate on the commercial real estate industry. My name is Cynthia Shelton and I have been in the real estate business for 32 years. In 2002 I was honored to be the CCIM¹ Institute International President, a 17,000 member commercial investment organization. I am a commercial real estate investment broker with the firm of Colliers Arnold in Orlando, Florida and also serve as a liaison to the National Association of REALTORS'[®] Leadership on commercial issues.

I am pleased to testify on behalf of the REALTORS[®] Commercial Alliance which represents the Institute for Real Estate Management (IREM), the CCIM Institute, the Society of Industrial and Office Real Estate (SIOR) and the REALTORS[®] Land Institute (RLI). Together, members of the REALTORS[®] Commercial Alliance are involved in all aspects of commercial real estate – from real estate brokerage to property management.

Overview of the Commercial Real Estate Markets and the Commercial Real Estate Profession

Commercial real estate is powerful engine of the national economy. It is where Americans shop, work, live and play. The health of the commercial real estate market generally mirrors that of the overall economy. However, it is best to look at commercial real estate as a quilt of local markets and submarkets, each susceptible to localized economic trends. Today's U.S. commercial real estate is worth approximately \$5 trillion, and includes 4 billion square feet of office space, 13 billion square feet of industrial property, 6 billion square feet of shopping center space, 4.4 million hotel rooms, and 33 million square feet of rental apartment space. America's 48,695 shopping centers account for \$2.12 trillion in sales in 2005 and generated \$114.4 billion in state sales taxes. And, the nation's multifamily housing provides homes for over 23 million households. Commercial real estate professionals navigate this quilt, with its patches of unique markets, to help clients make the best real estate decisions.

NAR's over 50,000 commercial members help clients with all aspects of their commercial real estate needs from negotiating leases on behalf of a retail or office client and negotiating a sale to an institutional investor to providing property management services. In the case of real estate development, commercial real estate professionals will help clients 1) locate an appropriate site,

¹ Certified Commercial Investment Member Institute

2) work with clients and financial institutions to create the most suitable financing plan, and 3) find suitable tenants for the space being developed. Commercial real estate professionals use their unique understanding of the economic health and risks of the local economy in providing these services. The OCC decisions expanding the authority of banks to develop real estate undermine the ability of commercial real estate professionals to work with financial institutions on a level playing field and further blur the line that distinguishes banking from commerce.

Impact of the OCC's Decision on the Commercial Real Estate Profession

As a commercial real estate professional who has developed close working relationships with large banks, I am concerned that the decisions by the OCC will compromise their ability to act as honest brokers of financial services. Now when I negotiate a transaction with banks and clients, I must ask myself, am I dealing with a financial service provider as part of a team or a potential competitor?

I've always understood that a key purpose of the national policy against mixing banking and commerce is to protect banks from the inherent risk posed by any commerce venture. Banks, because they have a duty to protect the savings of their depositors, and because their deposits are insured by the FDIC, strive to maintain soundness and stability by managing their risk, keeping sufficient reserves, and diversifying their loan portfolio. The terms of the loans banks make to commercial real estate development reflect their assessment of the risk associated with the venture in the context of the bank's overall soundness. In conducting their due diligence analyses, banks evaluate the strength of the business plan in their overall assessment of risk the loan poses to the institution. There is an implicit acknowledgement that the borrower assumes the risk of the venture's ultimate failure or success, and the bank must ensure that its soundness won't be unduly jeopardized by that risk.

The OCC's recent rulings complicate that mutually beneficial relationship by allowing banks compete in the business of real estate development. Could a bank change its lending criteria to favor a potential development deal in which it has a stake over another in which it doesn't? What would prevent a bank from taking advantage of the business plan of a sound commercial real estate venture that applies to the bank for financing? I can't believe OCC envisioned these scenarios, but I do not see anything that would prevent this from happening. I am concerned that the OCC may not have considered the potential impact of these decisions on a bank's ability to act as an honest broker of financial services.

It is important that Congress monitor the efforts that the Department of the Treasury and the OCC undertake to keep banks "honest brokers" in providing financial services, and to ensure that they do not become competitors of real estate brokers and agents and other commercial firms.

Importance of the Separation of Banking and Commerce to Commercial Real Estate

We believe that Congress requires separation of banking and commerce also for consumer protection and to enhance the safety and soundness of the banking system. I had personal experience with these issues when the separation was last breached during the devastating Savings & Loan crisis of the 1980s. Then, many Savings and Loans were permitted to invest in real estate developments and to make commercial real estate loans with little regard to sound risk

management principles -- such as an understanding of the local commercial real estate market. The historic collapse of the Japanese banking system of the 1990s is another example of the kind of problems that arise when banking and commerce mix. These examples remind us of the potential dangers and the unintended consequences of mixing banking and commerce. Thankfully, today because of new laws and strong underwriting standards and risk management practices, we believe a repeat of the late 1980s is highly unlikely.

The OCC decisions permit U.S. national banks to engage in the business of real estate development by developing and operating a luxury hotel; financing, developing, operating and leasing space in a mixed use building (including developing residential condominiums for sale). They need only argue that a small portion of the project is needed for bank premises or that a part of the project is needed to make the rest economically feasible. They may also hold a 70 percent equity stake in a windmill business, qualifying for special tax credits. Three national banks were given the green light to engage in these business activities. We can understand that banks may want to develop office space to house their operations. However, when banks are permitted to develop real estate where there is no direct relationship with their operations, and assume the risk of identifying office tenants, entering into lease arrangement with a large hotel chain, and selling condominium units, we feel that the line distinguishing banking and commerce has been crossed. The banks will have assumed the direct risks of success or failure – risks that have traditionally been borne by those engaged in the commerce of commercial real estate.

Conclusion

Though the commercial real estate market is strong on a national level, I remind you that the market is a giant quilt made up of local markets that can vary significantly and shift fairly quickly. When a bank is permitted to develop real estate, the bank does so in a specific localized commercial real estate market – and because we represent real estate professionals, we know first hand that each market carries its own unique set of risks that may one day jeopardize the success of that development. Banks should not be permitted to impair their safety and soundness by assuming the risks of commercial real estate development.

How many other national banks will engage in these real estate development activities tomorrow? How many banks will choose to develop risky commercial real estate ventures in weak local markets because of their easy access to capital? How far will the OCC go in granting this unfair business advantage to banks?

Let's hope we don't have to find out. We ask Congress to urge the OCC to curb the ability of banks to develop commercial real estate so that the distinction between banking and commerce is not diminished further, and the commerce of real estate is not undermined. Thank you for allowing me to testify before you today. I welcome any questions you may have.