

## PAYING THE TOLL ON CRE

by [Steve Brown](#)

We have all been driving along a road somewhere, when all of a sudden a toll booth seems to rise out of the highway. As we scramble for change, we immediately begin to slow down to 5 mph. As we exchange money with the toll taker, we hear them say, "Have a nice day" and get a funny feeling they enjoy taking our hard earned cash. As we roll up the window and begin to pull away, a quick glance in the rear view mirror confirms they are indeed smirking at us. While examiners aren't exactly toll takers, bankers driving along minding their own business along the road of CRE lending may be feeling that way. After all, there certainly are a lot of warning signs flashing right now in the sector. Given the discussions we have had over the past 2Y with banking regulators all over the country, plus the guidance released in December of last year and the changes required in the Call Report that rolled out in January 2006 - it is very, very clear that examiners are worried about the risk of CRE lending concentrations in banks (note that credit spreads have been roughly cut in half in the past 10Y). We have talked about this subject before, but today we want to focus in on one of the more challenging aspects bankers have been trying to address. Called "market analysis" in the guidance, bankers will need to provide some sort of market research and information (on a consistent basis) to senior management and the board related to the loan portfolio. The information should address geographic markets and property types within the loan portfolio, as well as describe credit trends. The goal of this section of the guidance is for bankers to have collected and presented enough market-related information to be able to demonstrate they have an understanding of the economic and business factors influencing specific lending markets. The information should give banks the ability to conduct stress testing, sensitivity analysis, pursue new lending opportunities and expand activities in other geographic areas. This component is critical, since it provides bank management and board with more detail to help evaluate strategies, adjust to changing market conditions, manage risk exposures and evaluate opportunities. This ensures the board has enough information to provide guidance and set strategy that bank management can then execute against (within an approved level of acceptable risk tolerance). For example, consider a bank with a concentration to office space in San Jose, CA and branches located in the same geographic area. If Oracle decides it is going to consolidate operations and suddenly thousands of square feet of space come onto the market, is the bank prepared? What about the CRE lender focused on the retail sector? If the bank has made loans to multiple retail centers with the same anchor tenant in many of them, what happens if that tenant has credit problems? Does the center still cashflow, how many months does the bank estimate it will take until another anchor tenant is found, will the rent need to be discounted to fill the space? Market analysis attempts to provide information so bankers can incorporate enough fine cuts on the loan portfolio to understand local/regional conditions, as well as industry specific ones. Finally, bankers should understand that board and management expectations of the marketplace may not be best source. Banks should be wary of their sources to ensure they are as unbiased as possible when addressing this requirement. Tip: A best practice in this area is to begin tagging loans on your core system with North American Industry Classification System (NAICS) codes. NAICS was developed as the standard for government statistical agencies when classifying businesses and providing published statistical data.

## BANK NEWS

**M&A**

The HC for American Bank (\$364mm, MD) will acquire Grange Bank (\$245mm, OH) for an undisclosed sum.

### **Employees**

A study by Careerbuilder.com finds the job factors most likely to influence job satisfaction and loyalty include pay (33% of employees are dissatisfied with their pay); advancement (35% of employees are not happy with advancement opportunities and 85% did not receive a promotion in 2006); balance (27% of employees said they are displeased with their work-life balance); training (33% of employees said they are dissatisfied with on the job training provided at their current employer).

### **Yields**

Those wondering why the 10Y Treasury yield seems stuck around 4.75% may want to know that foreign direct investment in the US is the highest of all countries, at nearly \$180B (about 78% higher than 2005). Rounding out the top 4, other countries receiving heavy overseas investing include Britain (\$175B), France (\$90B) and China (\$65B).

### **ATMs**

A recent study finds the average ATM handles 2,131 transactions per month and costs between \$9k and \$50k depending on functionality.

### **Bankruptcy**

Research from Harvard Law School finds medical-related bankruptcies have soared 2,200% since 1981.

### **Glengarry Leads**

Banks seeking to increase their customer base of small businesses may want to consider providing incentives to existing customers. Studies show some 69% of small business owners would tell someone they know to go into business, so why not position your bank at the front.

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