REGULATORY CRE GUIDANCE - PART 3

by Steve Brown

On Monday, we raised awareness about the new Policy Statement on Prudent Commercial Real Estate (CRE) Loan Workouts, highlighting its purpose and key risk management elements of workout programs. Tuesday, we worked through documentation requirements and what regulators expect from bankers when it comes to analyzing borrower repayment capacity and guarantees. Today, we move through regulatory expectations for assessing collateral values and loan classification.

As a baseline, the guidance reminds bankers that they are responsible for reviewing collateral valuations and need to make sure assumptions and conclusions of those valuations are reasonable. In addition, bankers should have specific references embedded within policies and procedures that dictate when valuations should be updated (as part of its ongoing credit review, when market conditions change or when a borrower's financial condition deteriorates).

When it comes to workout situations, the guidance indicates updated appraisals should address current project plans and market conditions that were considered in the development of the workout plan, including such factors as: performance of the project; conditions for the geographic market and property type; variances between actual conditions and original appraisal assumptions; changes in project specifications (e.g., changing a planned condominium project to an apartment building); loss of a significant lease or a take-out commitment; or increases in pre-sales fallout. In some cases, the guidance indicates new appraisals will not be needed if the bank's internal evaluation appropriately updates the original appraisal assumptions to reflect current market conditions and provides an estimate of the collateral's fair value for impairment analysis. We know, this is not what you have been hearing lately from exam teams, but perhaps this is a glimmer of light bankers have been looking for.

The guidance also focuses some time on what sort of documentation bankers should have in order to demonstrate accurate grading. For example, if a bank intends to work with the borrower to get a project to stabilized occupancy, then the guidance indicates banks can consider the "as stabilized" market value for risk grading. If, on the other hand, the bank intends to foreclose, then the fair value (less costs to sell) of the property should be used in its "as is" condition for risk grading. Expect examination teams to review collateral values based on the original appraisal, any subsequent updates and market conditions, including requiring a new valuation if weaknesses are noted in the process.

To determine whether a bank is being reasonable, the guidance suggests examiners will be looking at such factors as: current and projected vacancy and absorption rates; lease renewal trends and anticipated rents; effective rental rates or sale prices (including sales and financing concessions); time frame for achieving stabilized occupancy or sellout; volume and trends in past due leases; NOI as compared with budget projections, adjusted for reasonable operating and maintenance costs; discount rates and direct capitalization rates.

In general, examiners can adjust the estimated value of the collateral when underlying facts or assumptions are inappropriate, but they are not expected to challenge underlying valuation assumptions used in appraisals or evaluations when these assumptions differ only in a limited way from norms that would generally be associated with the collateral under review.

Clearly there is a lot of snow blowing around this snow globe of guidance and only time will tell what is behind the glass when all of that snow finally flutters to the ground. We are hopeful that this updated guidance serves to reduce industry shaking over time.

BANK NEWS

M&A

Bryn Mawr Bank Corp ($1.18B, PA) has entered a deal to purchase the holding company of First Keystone Bank ($523mm, PA). First Keystone will receive a per share offering of common stock $2.06 and 0.697 Bryn Mawr shares

Deposit Rate Restrictions

The FDIC provided the final rule on restrictions on deposit interest rates paid by less than well-capitalized banks or any institution operating under an enforcement order that contains a prescribed capital target.

Deposits

Across the US, deposits have increased 7.1% over 2009 to $7.56T. Banks below $5B in assets saw deposits jump 12.3%, reaching 11.4% of the nation's total. Meanwhile, those with assets between $5-50B saw a 4.8% boost to 22.8% in total and the largest banks grew 18.2% to 24.4% overall.

Housing Weakness

Goldman Sachs projects housing prices will fall 5% to 10% more by mid-2010 before stabilizing. Meanwhile, Moody's projects home prices will stabilize for now, but then fall again in 2010 through summer.

Small Business

A new survey finds 55% of small business owners rate the economy "poor" and 43% say it will be at least a year before their company recovers from the recession.

Apartments

Marcus & Millchap projects apartment vacancy will stabilize in 2010 and begin a strong recovery in 2011.

Foreclosures

The latest data from RealtyTrac finds the top 5 cities with the highest foreclosure rates are: Las Vegas, NV (1 in 20); Merced, CA/Cape Coral, FL (1x27); Stockton, CA (1x28) and Modesto, CA/Riverside CA (1x30).