THE WINDING ROAD OF CRE GUIDANCE - PART 5

by Steve Brown

This is the final day of our detailed analysis of the new Policy Statement on Prudent Commercial Real Estate (CRE) Loan Workouts. We know you are sad the journey has ended, but get some rest this weekend and gear up; because it is likely much more discussion on this topic will be forthcoming. In the meantime, we take our final turn down this long and winding road.

As with any statement, we were not surprised to see regulatory expectations for good reporting, making sure accounting rules were followed, having strong governance, ensuring strong internal controls and the like. Nor were we surprised to see a reiteration of updating written policies, procedures and enhancing transparency.

There were some specifics included in this version, however, that relate more directly to loan workouts that we think bankers will want to know beyond these basics. These included: making sure loan workout groups are correctly communicating with accounting and regulatory reporting teams on all loan restructurings (to ensure financial and regulatory reporting are presented accurately); having examiners review management reporting processes and reminding bankers that examiners need to have a clear understanding presented to them of the differences between credit risk management, accounting and regulatory reporting concepts (such as accrual status, restructurings and ALLL) in order to assess the adequacy of reporting practices (including loss estimates for off-balance sheet credit exposures such as loan commitments).

Some good news related to restructured loans included: reminders that a loan that has been restructured (so as to be reasonably assured of repayment and of performance according to prudent modified terms) does not need to be nonaccrual. However, the guidance quickly added that examiners would expect banks to support that with a current, well-documented credit assessment of the borrower's financial condition and prospects for repayment under the revised terms (otherwise, the restructured loan should remain nonaccrual).

Other guidance focal points related to assessing whether to place a restructured loan on accrual or nonaccrual included: consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan is returned to accrual status (generally would be a minimum of 6 months and would involve payments of cash or cash equivalents); and whether the restructure improved the collectibility of the loan in accordance with a reasonable repayment schedule (does not relieve the bank of the responsibility to promptly charge off all identified losses).

When restructuring loans, the guidance provided bankers with further information that will be considered by examination teams. These include: making sure the new loan improves the likelihood that the credit will be repaid in full under the modified terms; and evaluating whether the loan should be reported as a troubled debt restructure (TDR). The guidance reiterated that such determination requires consideration of all of the facts and circumstances surrounding the modification, as no single factor, by itself, should result in a TDR (again, good news and perhaps a bit more flexibility as long as documentation supports this).

Finally, the guidance zeroed in on the loan loss reserve. It reiterated that banks should estimate credit losses based on a loan-by-loan assessment for certain loans and on a group basis for others; indicated that TDRs are impaired, so they should generally be evaluated on an individual loan basis; and reminded bankers to consider the need to recognize an allowance for estimated credit losses on off-balance sheet credit exposures. In addition, the guidance indicated that when a CRE loan is performing, regulators do not require automatic increases in the ALLL solely because the value of the collateral has declined to an amount that is less than the loan balance (but also reiterated that lower collateral values should be incorporated when calculating loss rates).

All in all, after combing through the examples given in the policy statement and reviewing the format, it would appear this is a positive for community banks. So, while the industry road to recovery is long and winding, perhaps this turn isn't as sharp as those recently experienced.

BANK NEWS

TLGP

The FDIC has determined that that banks holding TLGP debt may (at the bank's option) treat the risk with a 0% risk weighting effective Sept 29, 2009.

FNMA

The GSE posted a $19B loss for 3Q. While 35% less than a year ago, it is higher than 2Q's loss of $15B. FNMA has requested $15B in capital from the Treasury, its 4th such request. On another note, Fannie will begin renting properties in foreclosure to their previous homeowners for up to 1Y.

CRE 3Q

According to the MBA, CRE lending dropped 54% in the 3Q compared to the same period last year. Shopping centers and malls fell 62%, as the dollar amount of loans fell 56% in office RE, 40% in multifamily and 46% in hotels.

Excess Reserves

The FRB reports banks are holding $1T in excess reserves at the Fed now, a new record.

Citigroup

In an effort to raise capital, the Bank plans to spin off its life insurance unit, Primerica, in an IPO.