Portfolio-Level Analysis Of CRE Loans

regulatory lending

Summary: According to an FDIC paper, most community financial institutions don't perform portfolio-level analysis of their CRE loans. Doing so can better prepare you for your next exam and the downturn.

The Bureau of Labor Statistics (BLS) indicates there are no formal requirements for becoming a life coach. That said, some of the best life coaches suggest the following to improve your life: 1) Focus on what's important; 2) Have less stuff; 3) Avoid worrying about matters that don't really matter; 4) Get organized; 5) Change gradually; and 6) Show compassion. While these are good, we have another tip to make your life as a banker easier.

Portfolio-level analysis of Commercial Real Estate (CRE) loans can help community financial institutions (CFIs) better understand concentrations and how risky exposures might be in a downturn. Sadly, most CFIs don't perform these types of analyses or don't do them well, according to an FDIC paper. In CFIs with higher levels of CRE loans, only 41% reported portfolio-level analysis that provided recommendations for action.

Problem CRE loans were a major contributor to CFI failures in the last recession. Poorly written and/or administered CRE loans left many CFIs vulnerable to failure when the economy tanked in 2008. The high failure rate of CFIs during the recession might have been diminished through the diligent use of portfolio-level analysis of CRE loans coupled with corrective action to reduce concentrations.

The volume of CREs loans plunged in the downturn and did not start to recover until 2013. Since then, CFIs have seen steady, and sometimes quite significant, CRE loan growth. By Q2 of last year, CFIs held $2.4T in CRE loans, a record high.

The FDIC encourages portfolio-level analysis of CRE loans to monitor risk appropriately. The FDIC says CFIs have made progress in this type of analysis, but that much more needs to be done. Not enough CFIs perform this level of analysis, and even among those who do, many are not approaching the measure with enough sophistication or depth.

By assessing the concentration and vulnerability of CRE loans at the portfolio level, CFIs can get a better perspective on how much risk they are carrying and better prepare them to manage it. In some cases, CFIs performed an analysis, but did not integrate the results into oversight and planning processes. In other cases, CFIs used unrealistic assumptions to reach conclusions or used industry data for their own data to assess risk.

Furthermore, several CFIs lacked protocols for dealing with rising CRE loan concentrations. Many had no contingency plans for dealing with concentrations either. In other cases, plans were too simplistic to enable effective action in the event of issues.

The FDIC is closely monitoring CFIs that have CRE loan concentrations and wants to see adequate and effective portfolio-level analysis. To stay ahead of the curve for your next exam and be better prepared for the next downturn, be sure to have a robust program that achieves this. For more information, check out our Stress Testing FIT solution, with portfolio-level analysis.

SAVE TIME AND MONEY WITH OUR STRESS TESTING SERVICE

It is important to stress test loans of all types from multiple perspectives and on a portfolio basis. Get expert help to save you time and money. Learn more about stress testing today.