Serving Your CRE Business Customers Going Forward

lending pandemic CRE

Summary: The world of commercial real estate (CRE) lending has changed virtually overnight given COVID-19. Three steps to keep you on track to best support your customers.

We found out that having 10 or more trees on your block can actually make you feel as healthy as someone 7Ys younger! We are not sure how they figured this out, but this is according to a study reported in the nature journal, Scientific Reports.

We don't have to tell you that the world of commercial real estate (CRE) lending has changed virtually overnight given the coronavirus, making you likely feel at least 7Ys older. Many local businesses with long histories of success had to close, and others followed. It is anticipated that many businesses will not recover given a lack of capital reserves to carry them through this period.

Restaurants have been especially hard hit. The National Restaurant Association reports 8mm industry employees have been laid off, and restaurants around the country are expected to lose $240B through this year. Experts are also projecting this crisis will only hasten the closing of retail businesses, as customers shift their preferences to purchasing online. Once the shelter-in-place orders are phased out throughout the country, as is slowly happening, it is likely that commerce will not be business as usual. Taking this into account, how can community financial institutions serve their customers going forward?

1. Executive teams will need to **review and reset** their approved forecasts, budgets, and personnel needs for the next 3Ys.

2. A **new lending strategy** needs to be communicated consistently throughout the organization to ensure all employees understand, support, and enforce it going forward. The strategy should establish more restrictive lending parameters, as well as specific criteria to lend to in the future.

For instance, CRE loans should not exceed a maximum of 75% loan to value (LTV). The difficulty will be in valuing the particular property, of course. Capitalization rates have increased a minimum of 1% on many real estate asset types and "comparative" sales referenced in new CRE appraisals are virtually meaningless at this point.

Another example is that existing rent rolls (the property owner's representation of rental income from an income-producing real estate asset) cannot automatically be accepted by the credit team when underwriting a CRE loan. Many tenants are requesting deferrals or they are simply not making such payments. Because of this, underwriters may have to rely on the borrower's business operating account activity to see whether all lease payments are being paid in full each month.

3. It is also very important to **thoroughly stress test** the entire CRE loan portfolio. Testing parameters should include higher vacancy rates, lower net rents, and an increase in capitalization rates for CRE properties, for example.

It is still a time of many unknowns. But, reassessing (your forecast and budget), recreating (your strategy) and re-stress testing (your loan portfolio) will help position you to serve your CRE customers well as they start to open up for business.

SAVE TIME AND MONEY WITH OUR STRESS TESTING SERVICE

Now more than ever, 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.