



**Comptroller of the Currency
Administrator of National
Banks**

Commercial Real Estate

2011 Interagency MDI Conference

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**Darrin Benhart
Director - Commercial Credit Policy**

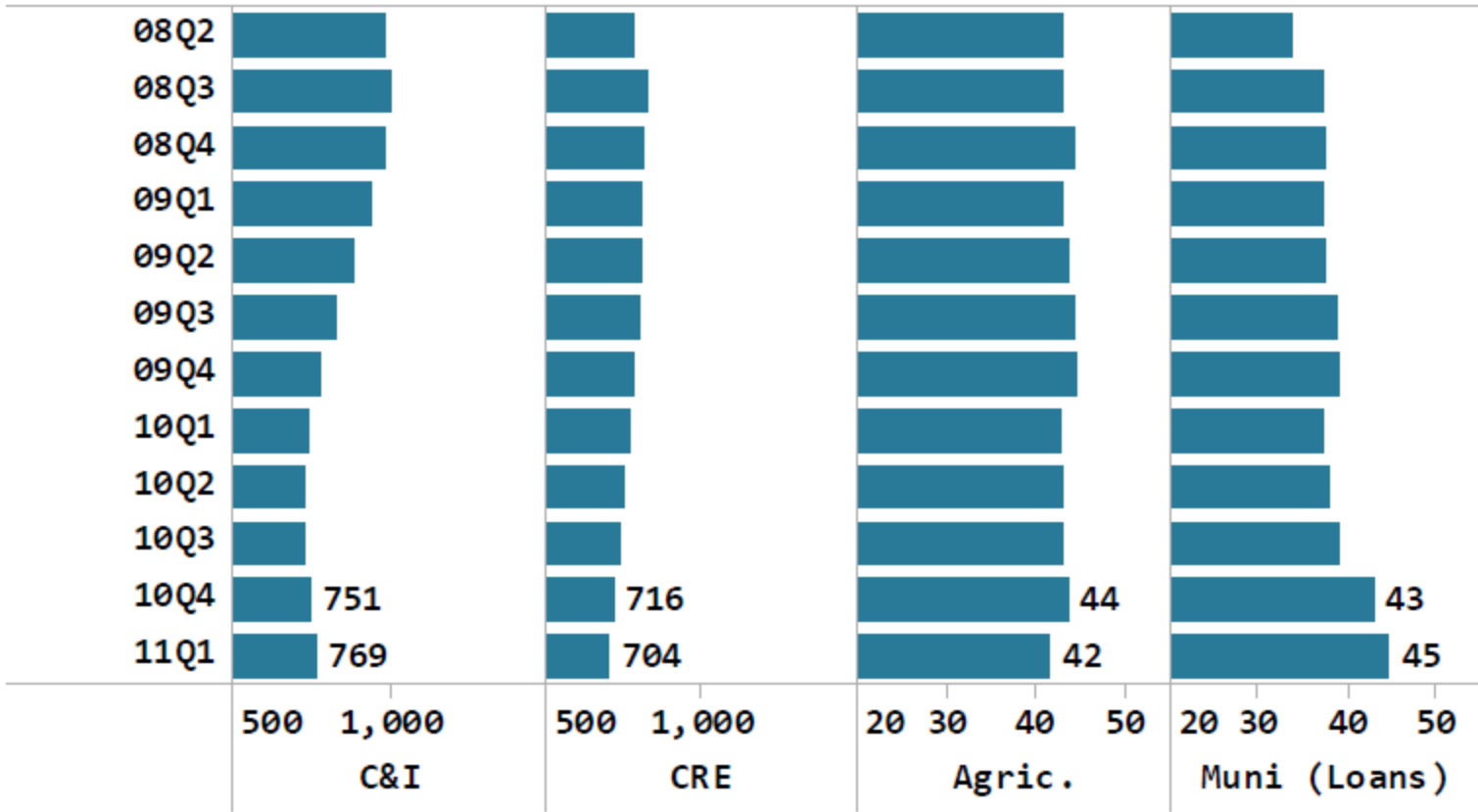


Agenda

- CRE Portfolio
 - Concentration/Volume
 - Performance
- Other Issues in Commercial Real Estate
 - Stress Testing
 - Interagency Workout Guidance
 - Appraisals
- Troubled Debt Restructures
 - Trends
 - Financial Distress/Concessions
- OREO
 - Trends
 - Guidance on OREO exchanges
- Credit Underwriting Survey

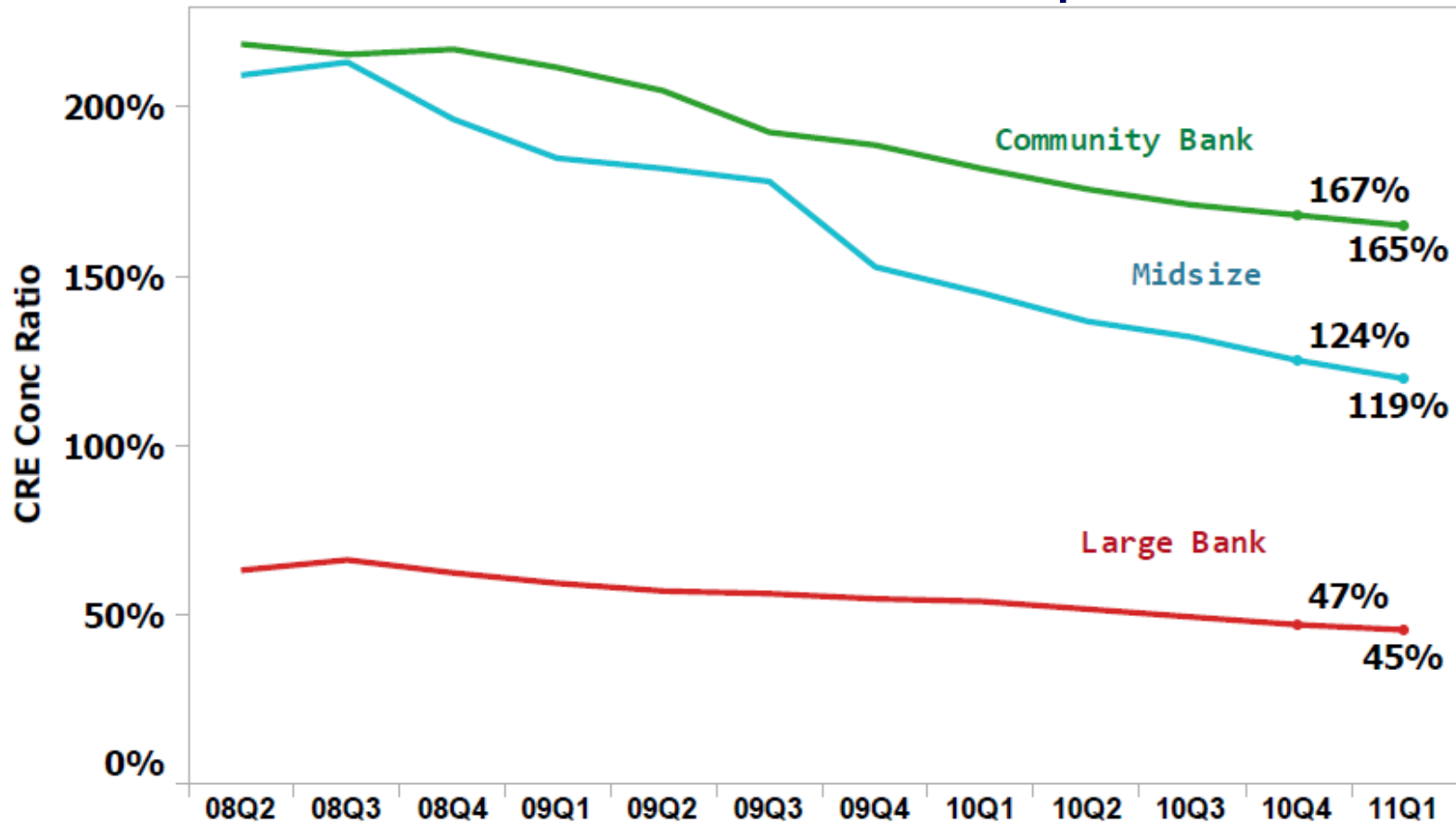


Commercial Loan Balances, National Banks, \$Bn





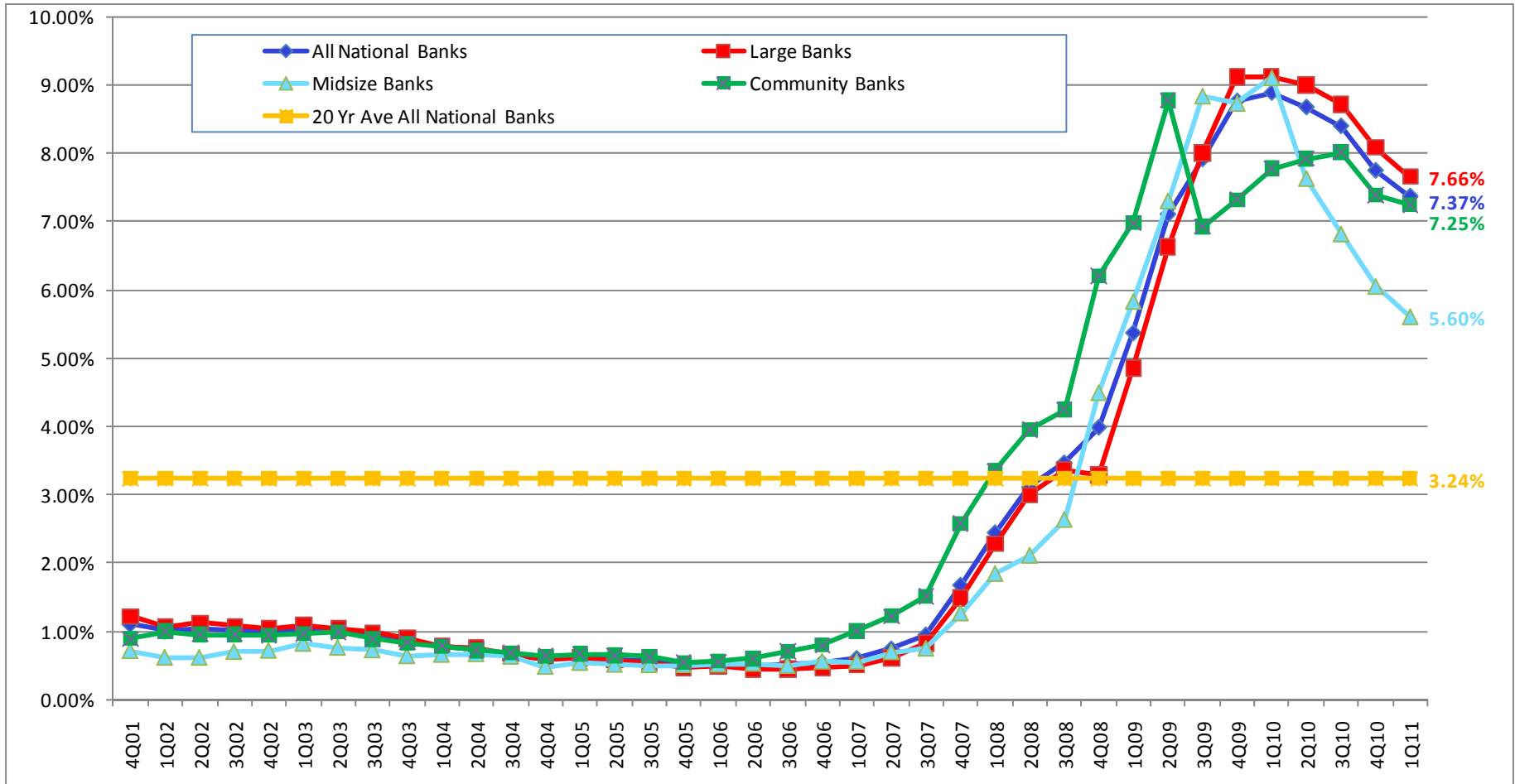
CRE as a % of Capital



National banks. Guidance definition, excludes owner-occupied nonfarm nonres., includes C&I for CRE purpose. Source: OCC IBIS.

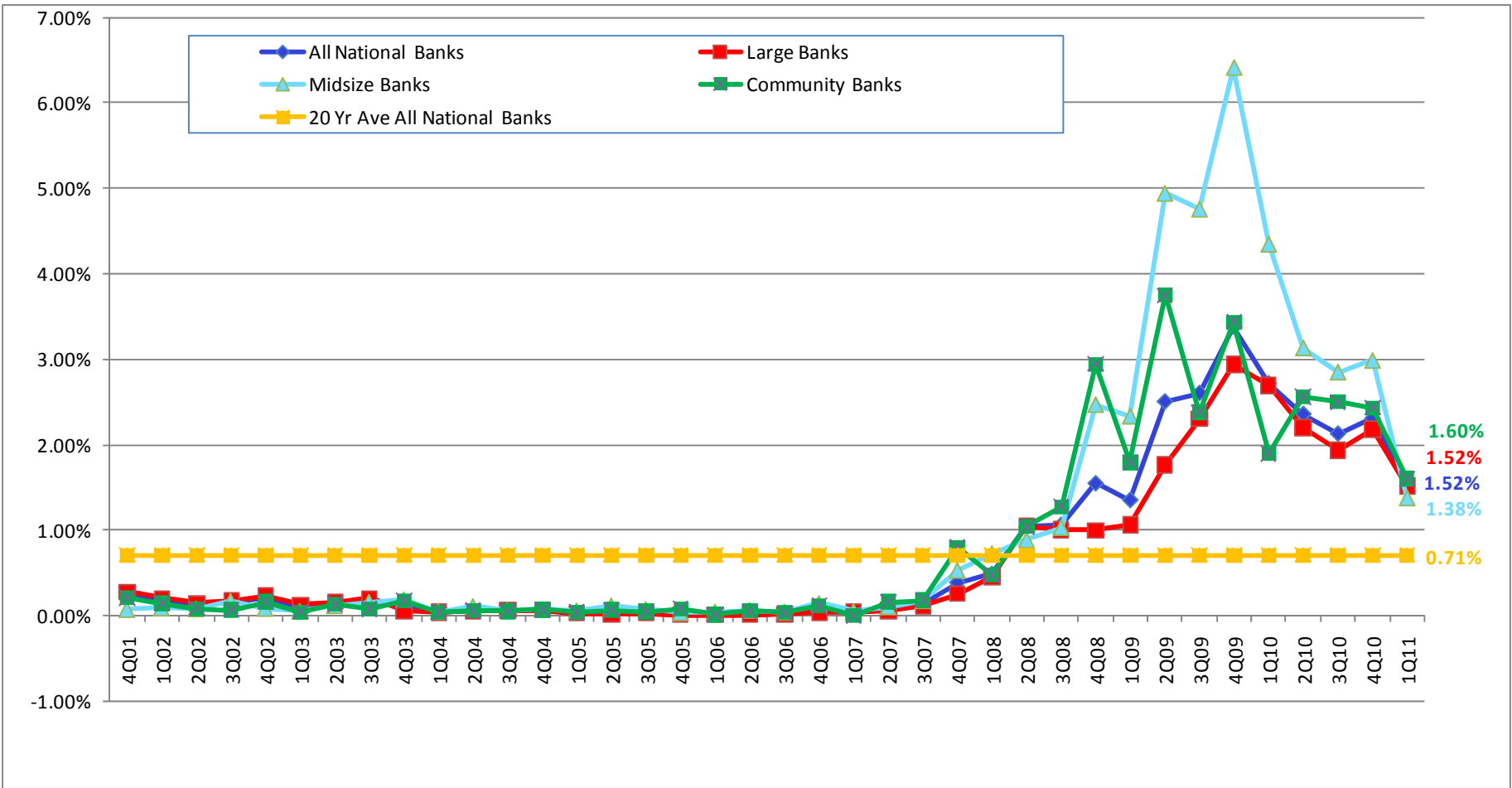


CRE Portfolio Performance -- Nonperforming



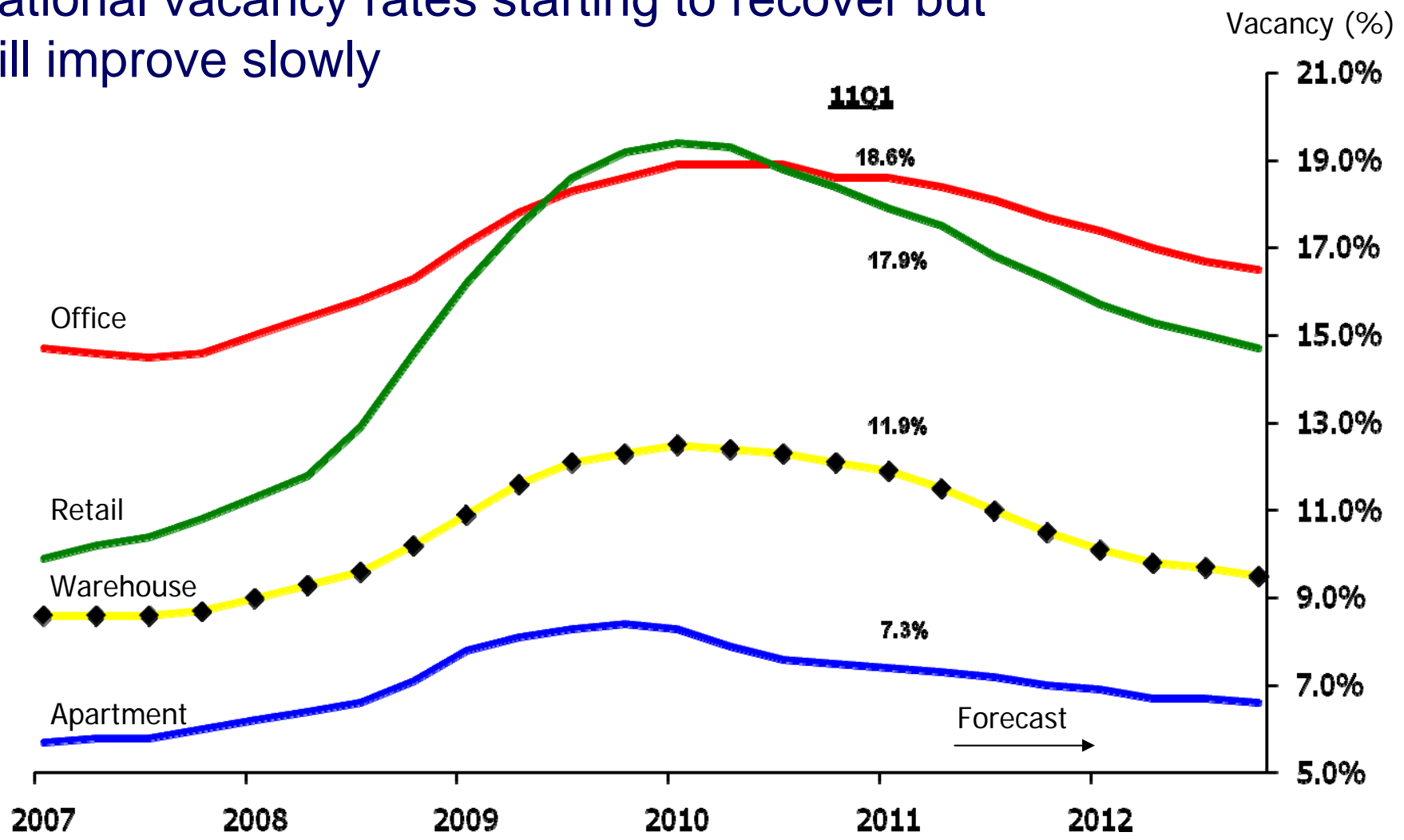


CRE Portfolio Performance – Ann. Net Losses





National vacancy rates starting to recover but will improve slowly

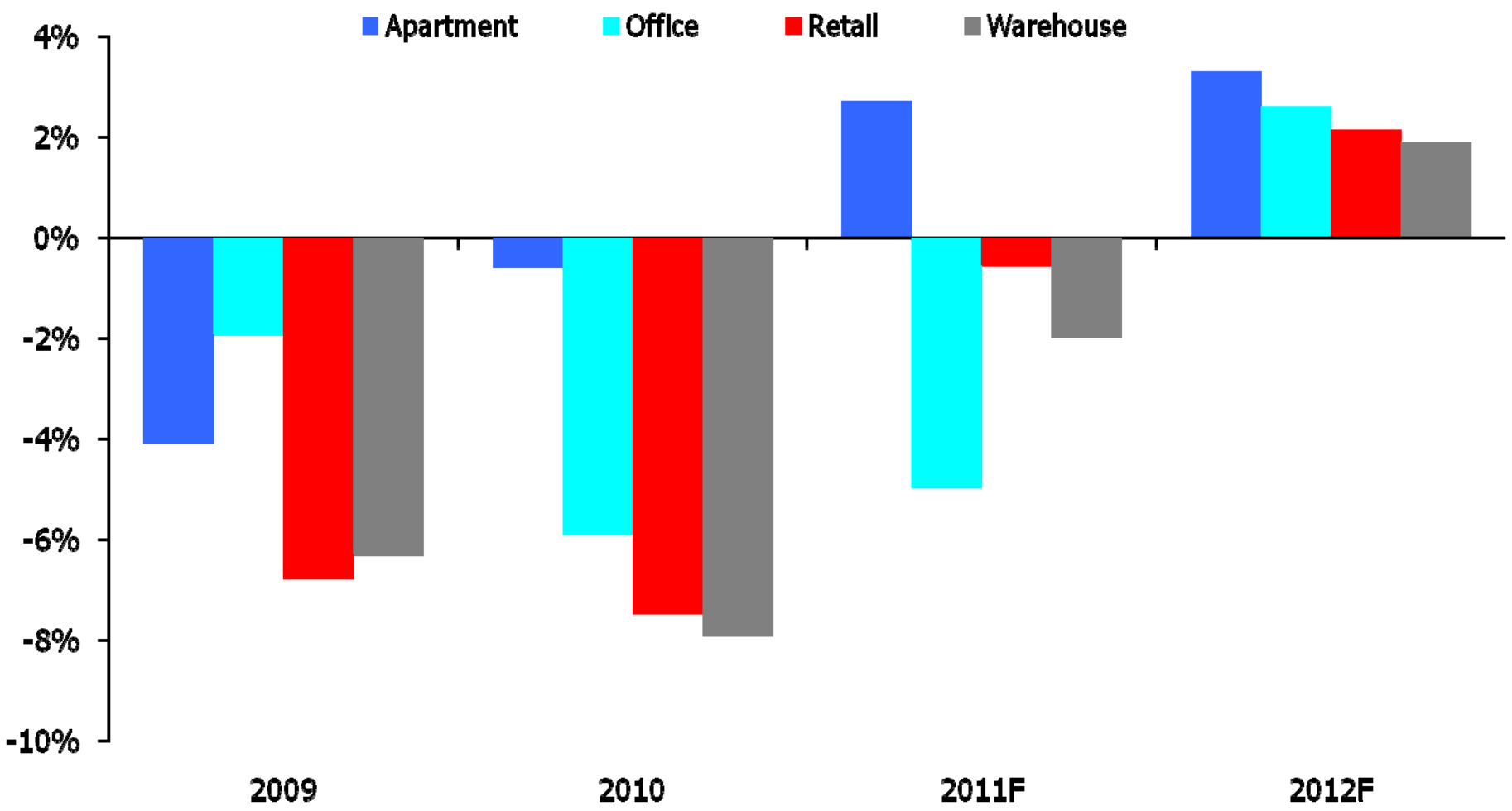


Source: Property & Portfolio Research; 2011Q1 forecast



Net operating income (NOI) will recover slowly

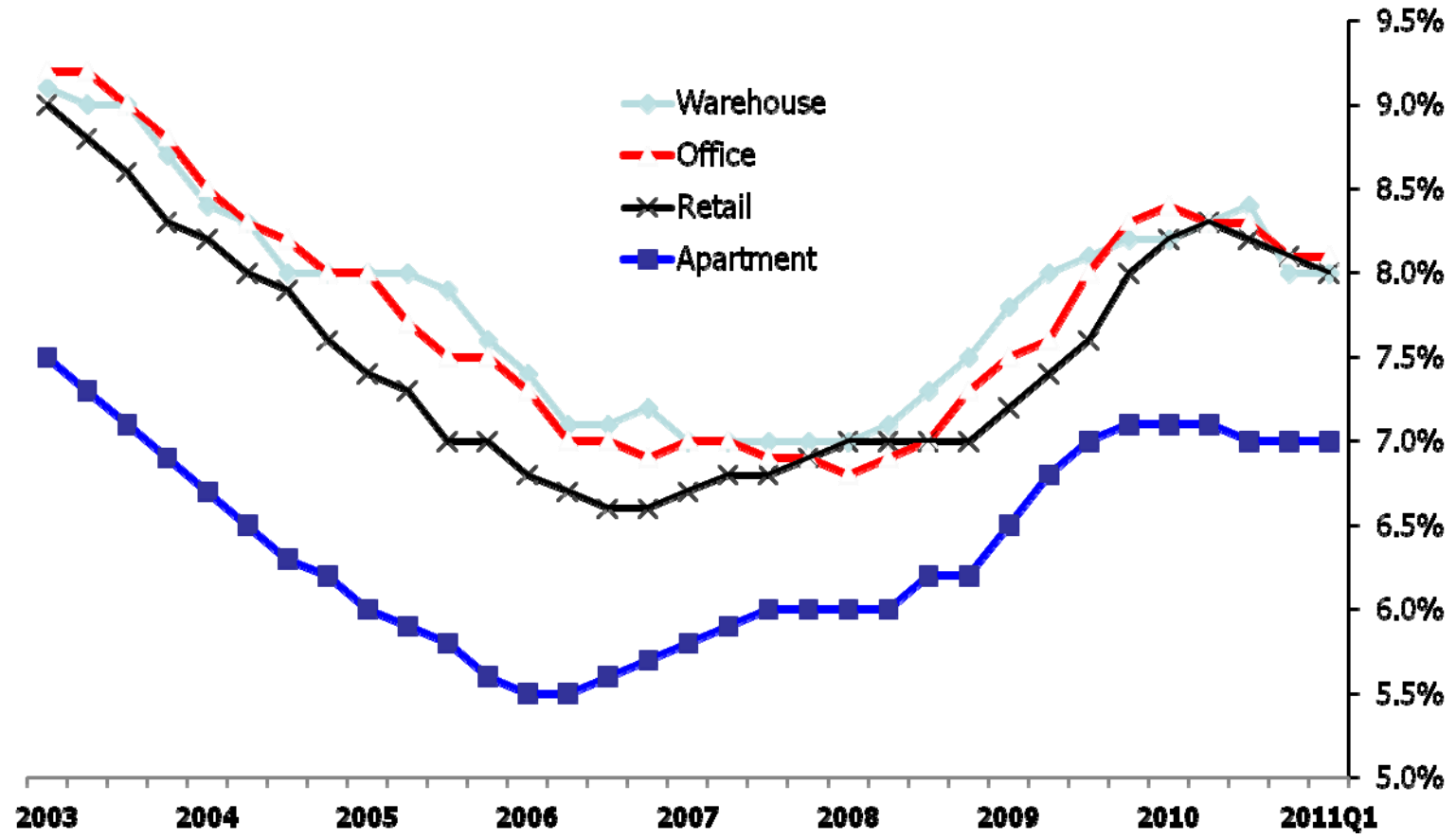
Annual NOI growth



Source: Property & Portfolio Research; 2011Q1 forecast



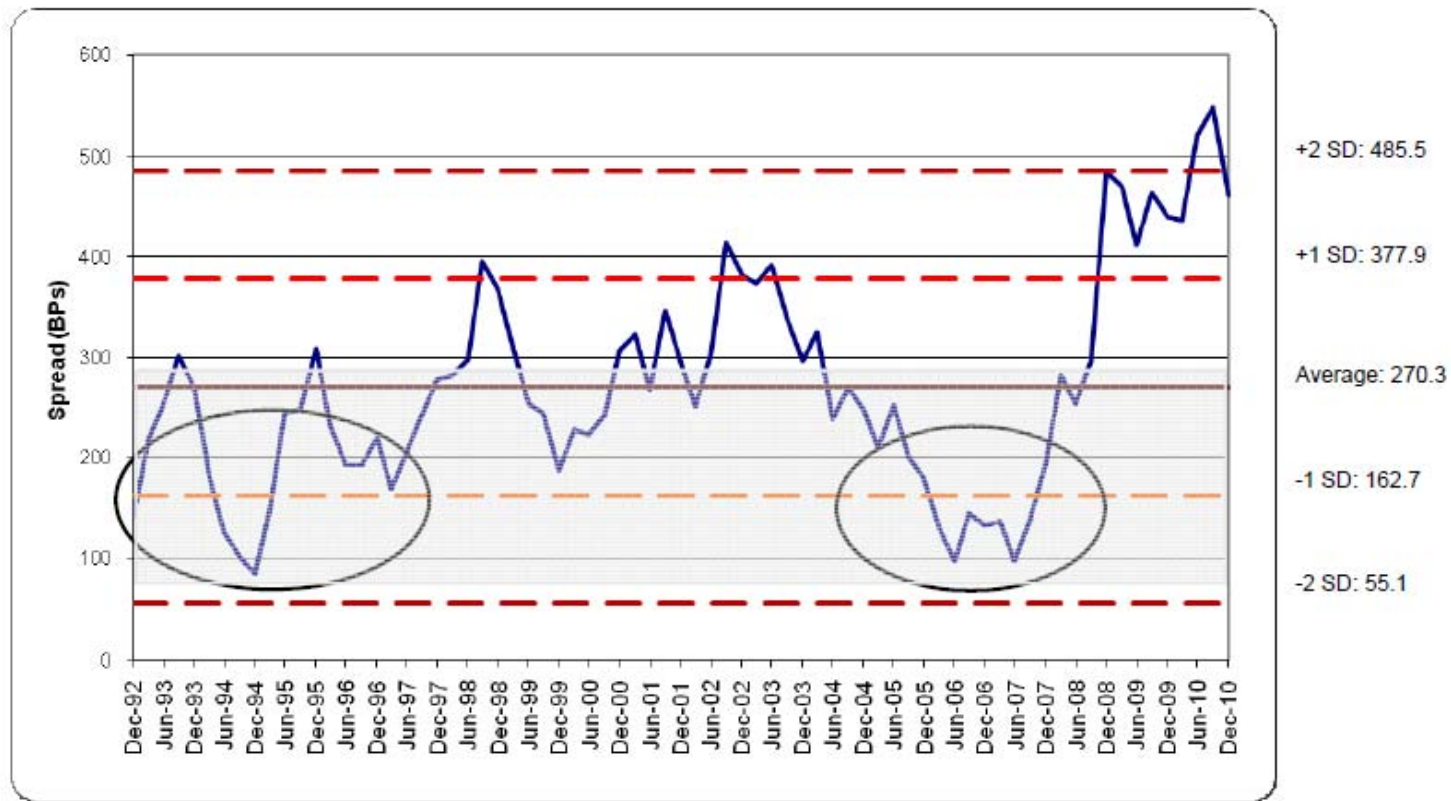
Cap rates flat or down slightly across property types



Source: Real Capital Analytics; through March 2011; transaction-based



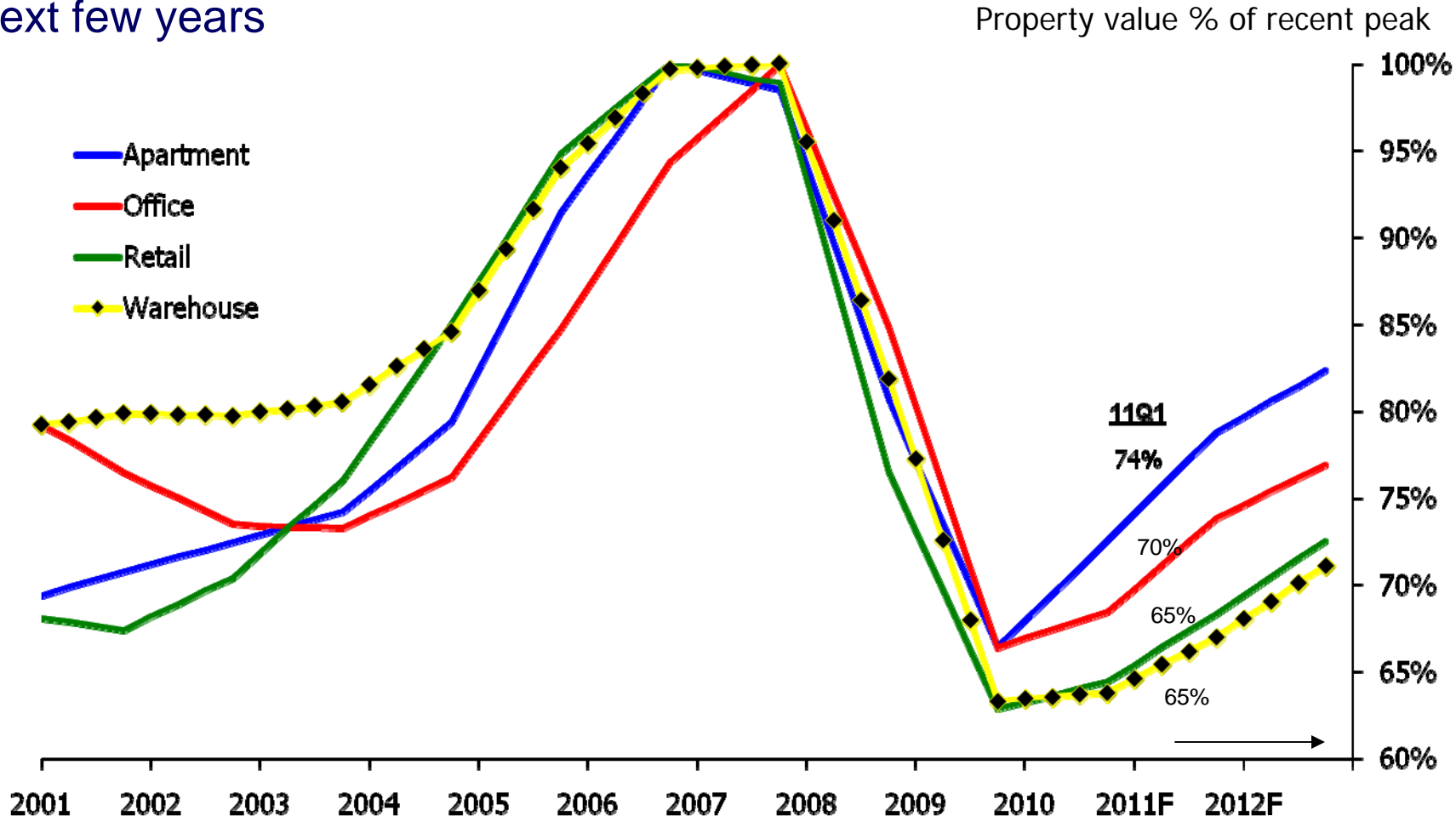
Spread Between CRE Cap Rate and 10 Year Treasury



Source: Cap Rate definition from PPR: Calculated by dividing forecast NOI over the next year by today's modeled value.



Property values will recover slowly with prior peaks well out of reach over the next few years



Source: Property & Portfolio Research; 2011Q1 forecast



Stress Testing

- What is stress testing?
 - Sensitivity Analysis
 - Portfolio Stress Testing
 - Enterprise (Macro) Stress Testing
- Approaches
 - Top Down
 - Macroeconomic based
 - Portfolio-wide assumptions
 - Bottom Up
 - Loan level assumptions
 - “Roll-up” of results
 - Can tie assumptions to macro scenarios
- Validation
 - Evaluate actual relative to predicted results



Benefits of Stress Testing

- More informed strategic decision making
- More accurate enterprise risk analysis
- Improved risk identification and rating accuracy
- Provides assessment of concentration risks, guides risk limits
- May impact credit policy decisions
- Support ALLL methodology through qualitative factors



Prudent CRE Loan Workouts

- Interagency Statement updates and replaces 1991 CRE guidance
- Promotes supervisory consistency
- Addresses risk management elements for loan workout programs, classification of loans, and reporting considerations
- Principles also apply to other commercial loans



Prudent CRE Loan Workouts

- Risk Management Elements for Loan Workout Programs
 - Infrastructure, policies, procedures
- Loan Workout Arrangements
 - Loan structure, analysis, collateral, guarantees
- Classification of Loans
 - Performing/non-performing, partial charge-offs, two note split
- Regulatory Reporting and Accounting Considerations
 - Nonaccrual, ALLL, TDRs



Appraiser Selection and Engagement Process

- **Selection process:**
 - Independent from loan production
 - Based on Appraiser Competency:
 - Geographic competency
 - Property Type Competency
- **Communication with the appraiser**
 - Fine line: preserve independence (lack of pressure); provide information to appraiser in timely fashion
- **Engagement letter**
 - Spell out valuation assignment requirements:
 - Market Value
 - Scope of Work
 - Appraisal Report Type (Good Practice: Self-Contained or Summary)



Appraisal Review

- Competence of reviewer
 - Property type expertise
 - Independence from transaction
- What type of review?
 - Compliance (with basic regulatory requirements)
 - Technical (May be Standard 3 Review: USPAP)
 - Not a “one size fits all”
- If review issues – communicate with appraiser
- Document review in Loan File



Evaluations

- Minimum Requirement for three exemption situations:
 - Threshold: \$250,000 transaction value – Evaluation allowed
 - Business Loan exemption (meeting certain conditions) - Evaluation allowed
 - Subsequent transaction
 - No New Monies (except reasonable closing costs) – Evaluation is allowed
 - New Monies
 - Deterioration in market conditions – Appraisal required
 - Deterioration in physical aspects of property – Appraisal required
 - Deterioration in both – Appraisal required
 - No Deterioration in either – Evaluation is allowed



Evaluations

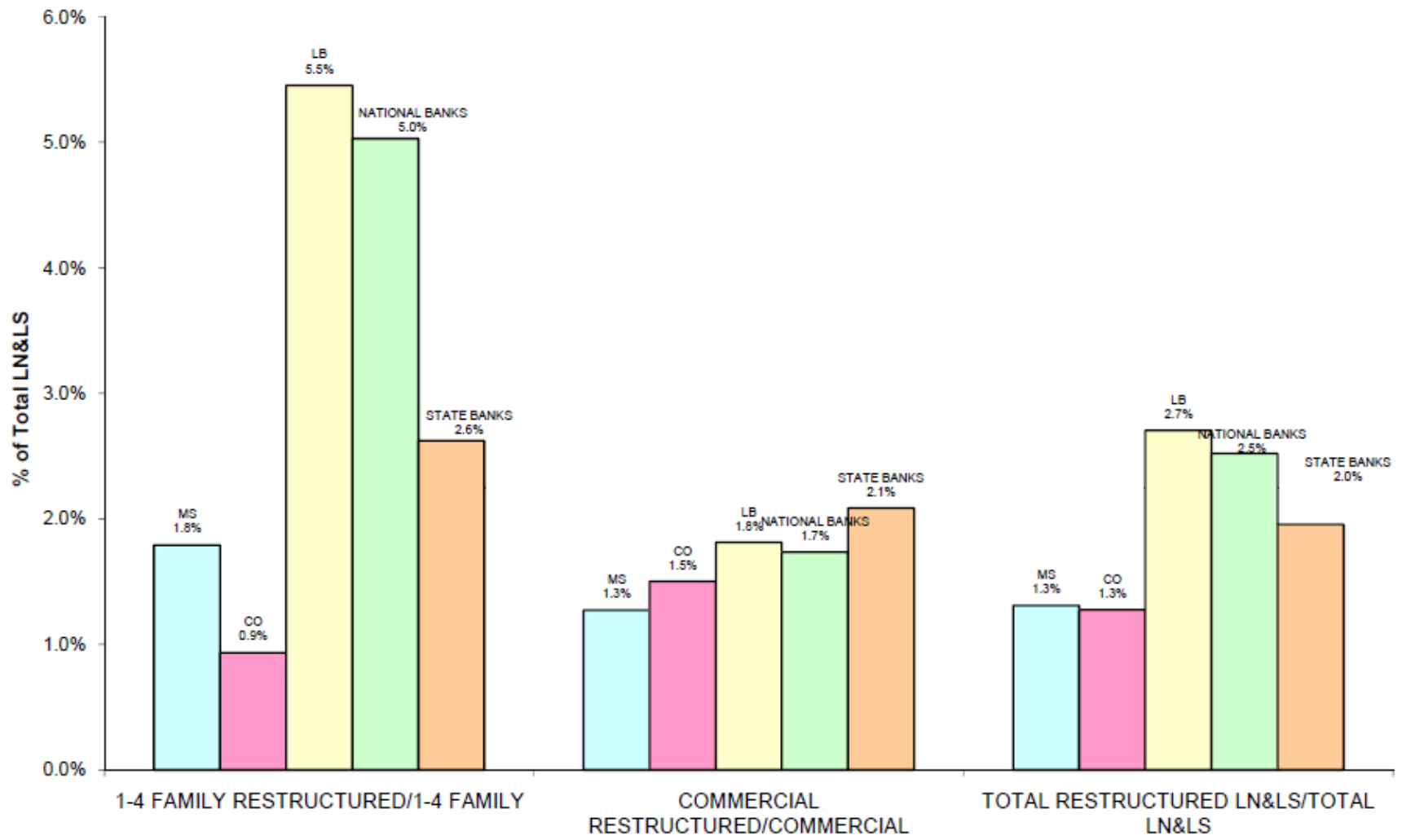
- Can be performed in-house or by third party
- Person performing Evaluation:
 - Independent
 - Competent: Document qualifications and experience level of individuals deemed acceptable for purposes of preparing evaluations, based on:
 - Training
 - Experience
 - Evaluation must elicit Market Value
 - Evaluation Contents: spelled out in Interagency Appraisal and Evaluation Guidelines



Troubled Debt Restructuring

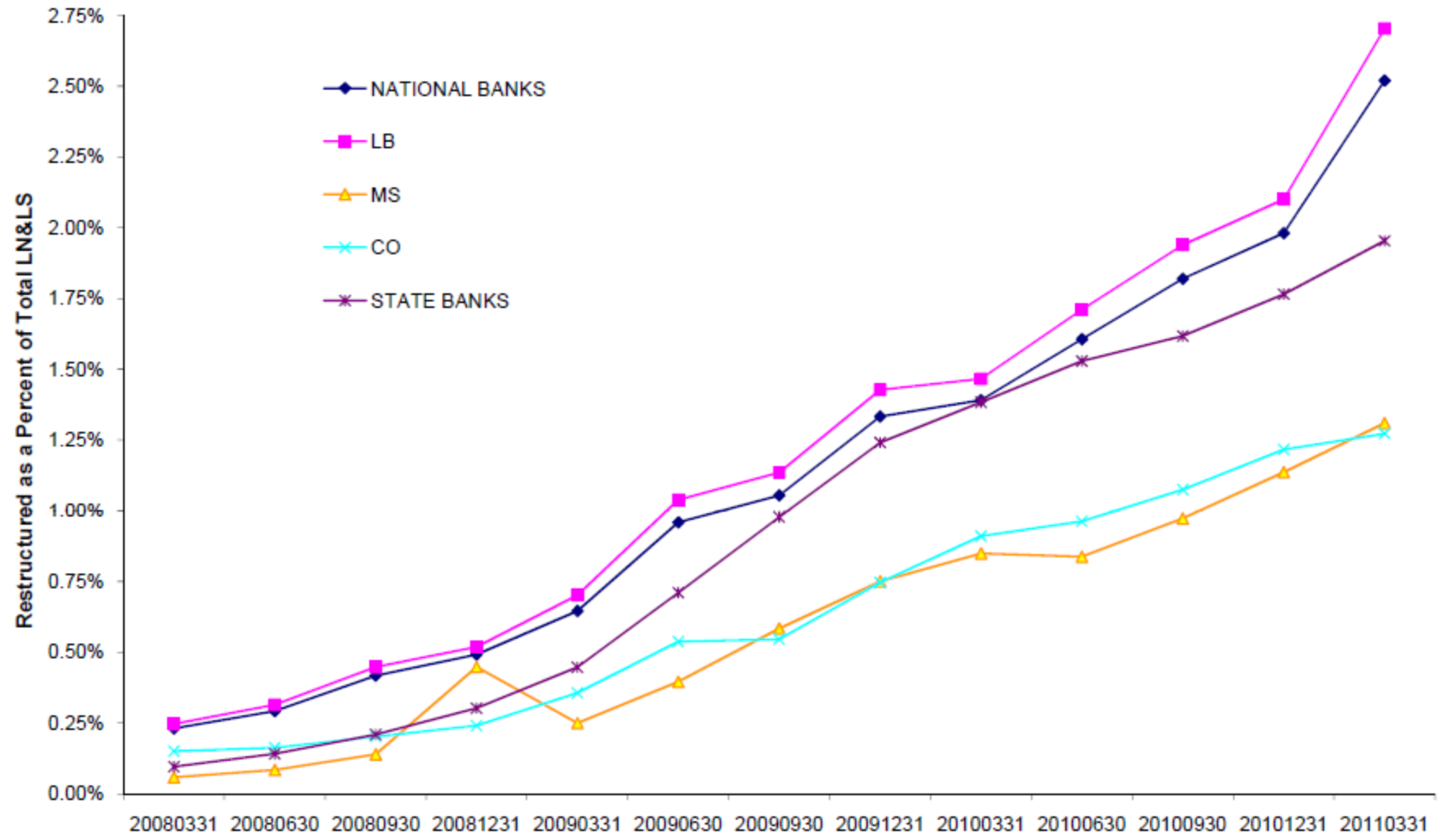
Troubled Debt Restructurings: 1Q 2011

Restructured LN&LS as a Percent of Total LN&LS



Troubled Debt Restructuring

Restructured LN&LS as a Percent of Total LN&LS





Troubled Debt Restructuring

- A loan modification constitutes a TDR when two conditions are present:
 - Borrower is experiencing *financial difficulty*
 - Creditor grants a *concession* it would not otherwise consider but for the borrower's financial difficulties



Financial Difficulty and Concessions

Determining if a borrower is experiencing financial difficulty:

- Default on any debt
- Debt service capacity
- Deteriorating collateral values (e.g., LTV of CRE project)
- Viability & prospects of business/project
- Are payments being kept current with an interest reserve?

Determining if a concession has been granted:

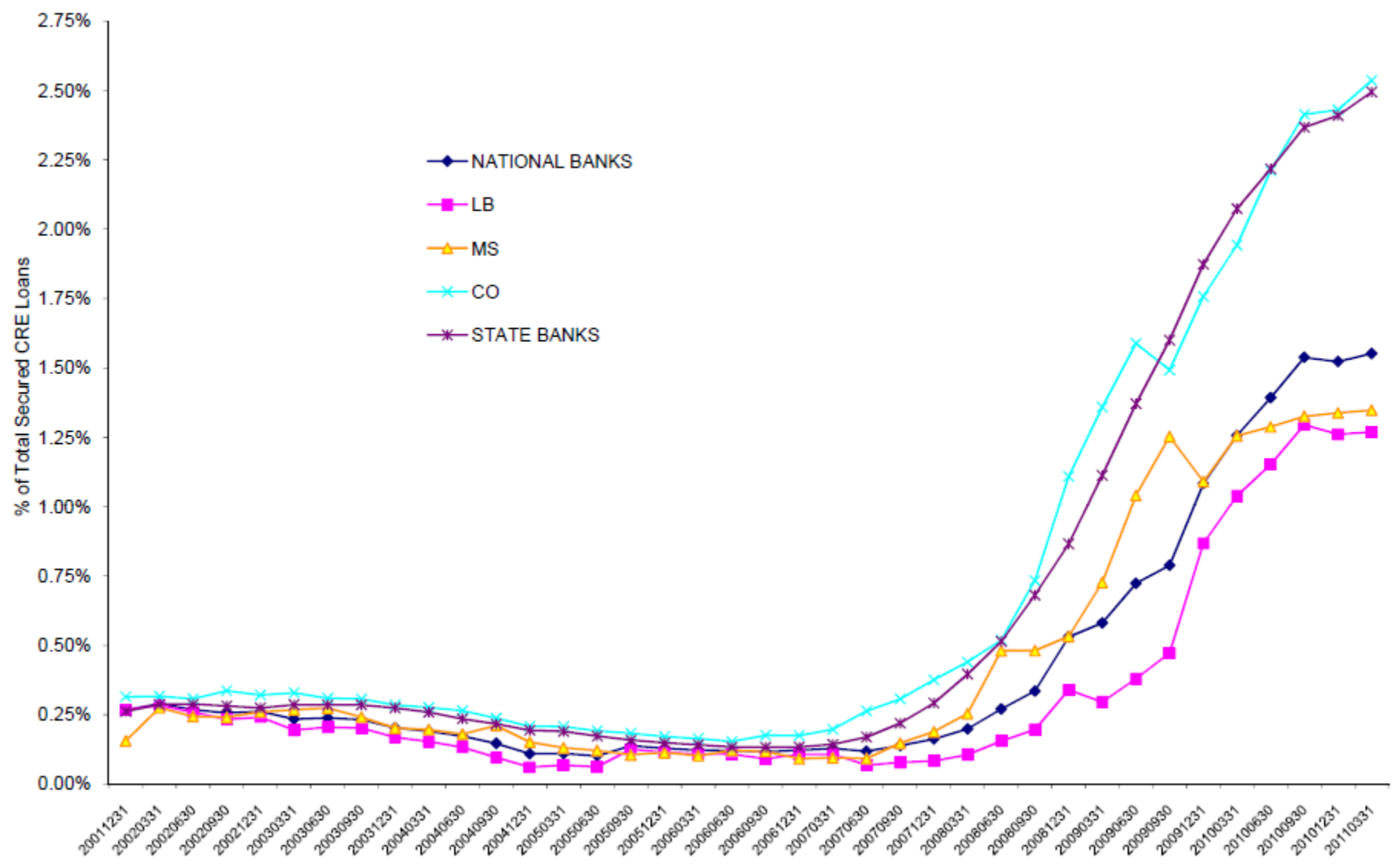
- Effective borrowing rate
- Maturity of loan
- Amortization period
- Terms as compared to prior debt
- Terms as compared to other loans with similar risk
- Concessions from borrowers



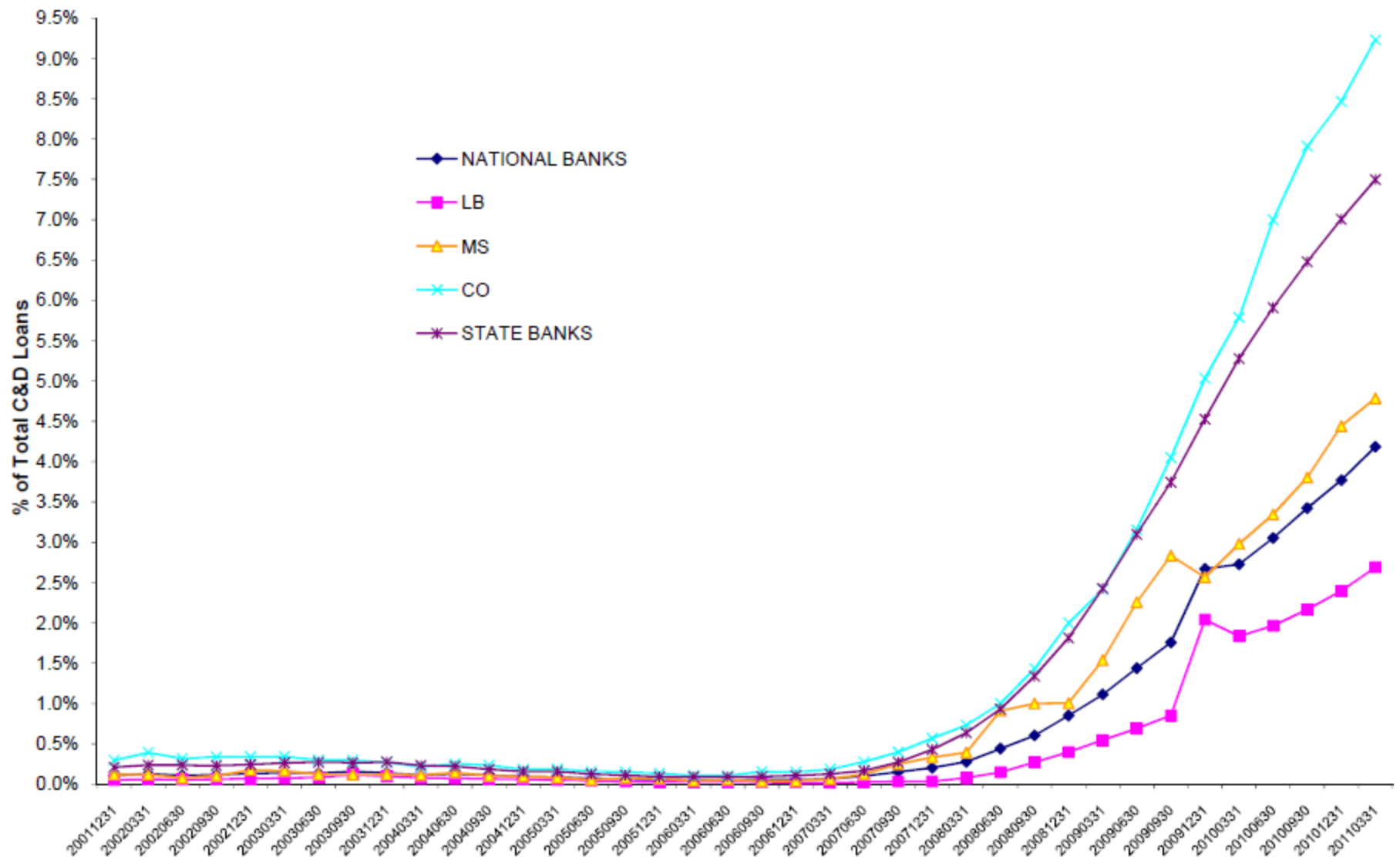
Multi-Note Split

- A troubled loan is formally restructured into two notes:
 - A portion of the current outstanding debt separated into a new legally enforceable note (i.e., the first note) may be placed back on accrual status in certain situations.
 - Reasonably assured of repayment according to prudently modified terms
 - Sustained payment performance for a reasonable time (performance prior to the restructuring may be taken into account)
 - The portion of the debt that is not reasonably assured of repayment (i.e., the second note) has been charged-off.
- An assessment of the borrower's financial condition and the prospects for full repayment of the first note should be well-documented

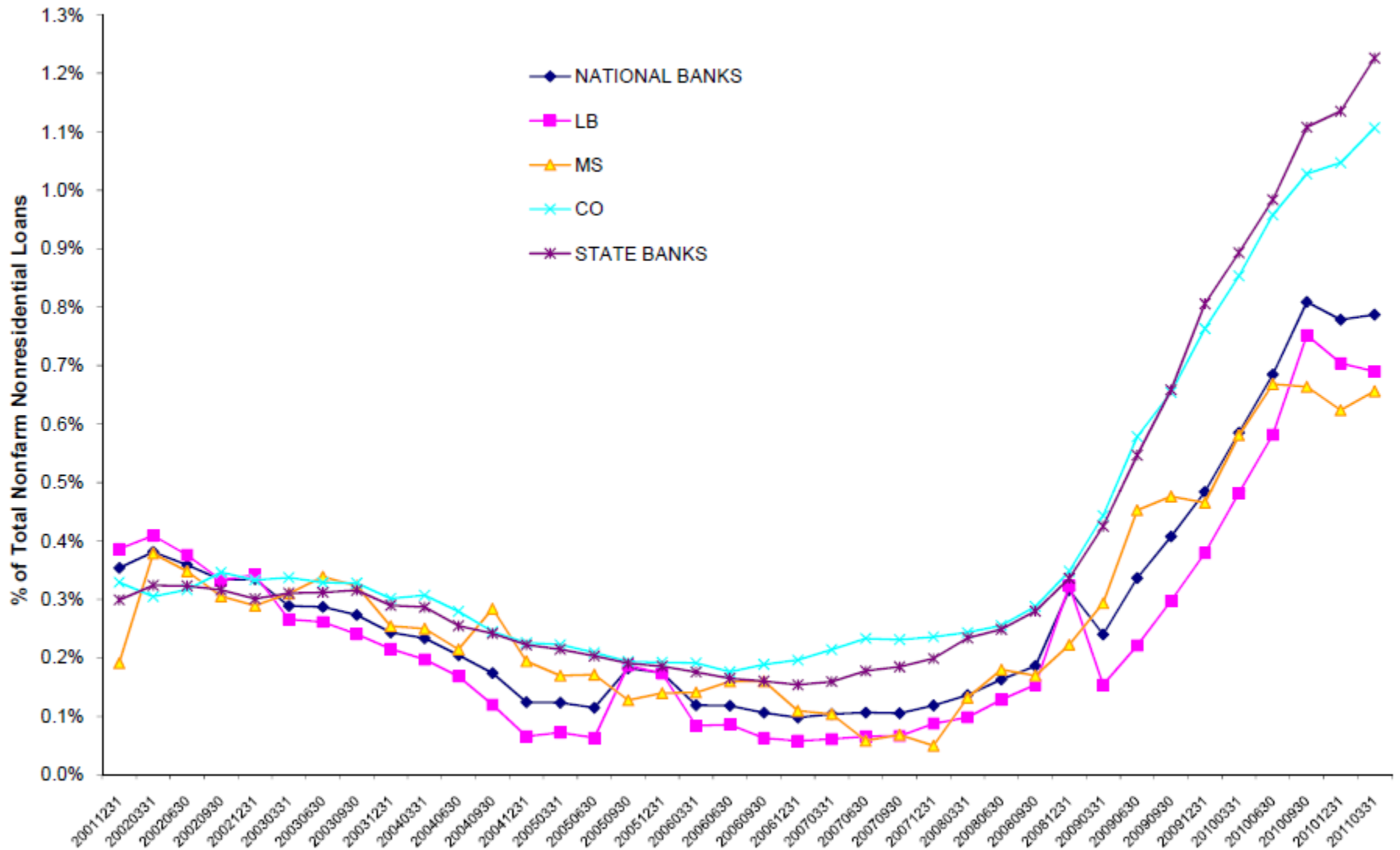
Commercial OREO as a % of Total Secured CRE Loans



C&D OREO as a % of C&D Loans



Non farm, non residential OREO as a % of non farm, non residential loans





OREO

Increase in OREO balances and inability to sell has led to banks' desire to exchange OREO assets

Common issues associated with the exchange of OREO assets for an equity interest (generally in an LLC) include:

- The bank's loss of control over its OREO assets,
- The exchange of OREO for an asset of questionable liquidity and value,
- The commingling of the bank's OREO with other real estate that may be of poorer quality,
- Significant up-front fees and recurring management fees paid to the organizing company, and
- Unfavorable priority of payments between the banks and equity investors.



Considerations for OREO Exchanges

- Is the exchange permissible and in the best interest of the bank?
- What is the proper accounting treatment?
- How will exchange will make the real estate more marketable?
- Ensure that an accurate & updated value of the exchanged asset is established
- Ensure adequate risk management, measurement systems, and controls
- Monitoring to avoid multiple exchanges for interests in any other property
- Compliance with OCC's OREO regulation, 12 CFR 34
- Conduct adequate due diligence
- Holding period



2011 Credit Underwriting Survey

- Findings
 - Underwriting standards are in transition
 - Survey showed some signs of easing especially in commercial and industrial products
 - Many products standards remained unchanged or tightened especially for products with poor performance



Recent References

- OCC 2011-10 - Other Real Estate Owned: Exchanging Other Real Estate Owned for Other Assets
- OCC 2010-42 - Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines
- OCC 2009-32 – Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts
- OCC 2006-46 - Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices



Comments or Questions?