



Current Issues in Commercial Real Estate Lending

Regulatory Concerns Prior to COVID19

- ❖ Historically Low Interest Rates and Capitalization Rates Coupled with Rising Collateral Values
- ❖ Excess Liquidity and Pressure to Grow Assets and Earnings
- ❖ Easing Underwriting Standards
 - Less Restrictive Covenants
 - Extended Maturities/Amortizations
 - Longer Interest Only Periods
 - Limited Guaranty Requirements or Non-recourse
 - Greater Number of Underwriting Exceptions
- ❖ Insufficient Monitoring of Market Conditions

Impact of Market Disruptors and COVID on Commercial Real Estate (CRE)

- ❖ Examples
 - Amazon/Walmart
 - Apple/Samsung
 - Alphabet/Google
 - Amazon/Microsoft/Google – Cloud Computing
 - Netflix/HBO/Disney/Hulu/Amazon Prime/Redbox
 - Uber/Lyft
 - DoorDash/Uber Eats
 - Airbnb
 - WeWork – Shared Space Office and Apartments
 - Zoom/Webex/Microsoft Teams/GoToMeeting
 - Artificial Intelligence and Robotics
- ❖ COVID 19 Accelerated the Impact of Disruption
- ❖ Covariance and Contagion
- ❖ Impact
 - Rollover Risk
 - Gross Potential Rent
 - Vacancy e.g., Physical vs Economic Occupancy
 - Operating Expenses
 - Capitalization Rates
 - Collateral Values

- ❖ Property Types at Risk
 - Office
 - Hospitality including Hotels and Restaurants
 - Retail
 - Multifamily
 - Student Housing
 - Auto Dealerships
 - Theatres
 - Senior/Assisted Living

Impact of Change in Accounting Treatment of Operating Leases

- ❖ Lessee Financial Leverage and Debt Service Coverage
- ❖ Underwriting Guidelines
- ❖ Lease Terms and Rollover Risk
- ❖ Owner Occupied Real Estate
- ❖ Bank Branch Leases and Impact on Capital

Assessing the Impact of COVID 19 on CRE Borrowers and CRE Portfolio Performance

- ❖ Borrower Stress Testing
 - Breakeven Occupancy and Rental Rate
 - Breakeven Debt Service Coverage
 - Loan to Value
 - Liquidity/Financial Leverage
 - Ability to Refinance Maturing Debt
- ❖ Portfolio Stress Testing
 - Loan Demand
 - Net Interest Margin
 - Portfolio Credit Quality – Criticized/Classified
 - Earnings
 - Capital

Steps Your Bank Should Be Taking Now

- ❖ Identify Portfolio Concentrations e.g., Borrower, Property Type
- ❖ Monitor Maturities Particularly Interest Only Loans
- ❖ Affirm the Asset Quality Rating Assigned to Larger Relationships Especially Those Originated in 2018 and 2019
- ❖ Review the Real Estate Portfolio Assessing the Potential for Covariance/Contagion
- ❖ Evaluate the Direct, Indirect, and Contingent Liabilities of Larger Borrowers
- ❖ Assess the Global Cash Flow, Leverage, and Liquidity of Larger Borrowers/Sponsors
- ❖ Stress Test All Larger Borrowers in the Lowest Two Pass Categories
- ❖ Meet with the Sponsors of the Largest and Lowest Pass Rated Exposures Focusing on Steps They are Taking to Change Their Value Proposition or Reposition/ Repurpose Their Properties to Deal with the Challenges Presented by the Current Market Environment
- ❖ Increase the Bank's ALLL Provision Using the Qualitative "Q" Factors as Justification