



Current Issues in Commercial Real Estate Lending

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Regulatory Concerns Prior to COVID 19

- ❖ Historically Low Interest 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

Lessons to be Learned from Prior Credit Crises

- ❖ History Repeats Itself - The More People Tell You It's Different this Time the More it May be the Same
- ❖ Other Banks are Doing Crazy Things, but We are More Conservative
- ❖ Aggressive Underwriting in Higher Risk Types of Lending and Allowing Concentrations to Build in the Portfolio Can be Fatal
- ❖ Capital and Liquidity Buy Time to Solve Earnings and Asset Quality Problems

Prior Credit Performance is a Very Poor
Predictor of Future Credit Performance
and the Strength of the
Bank's Credit Process

Reversion to the Mean is a More Reliable
Predictor of Future Events than the
Extrapolation of Recent Events

Disruption in Commercial Real Estate

Market Disruptors

- ❖ 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

COVID 19 Accelerated the Impact of Disruption

Market Disruptors

cont.

- ❖ Covariance and Contagion
- ❖ Impact
 - Rollover Risk
 - Gross Potential Rent
 - Vacancy e.g., Physical vs Economic
 - Operation 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

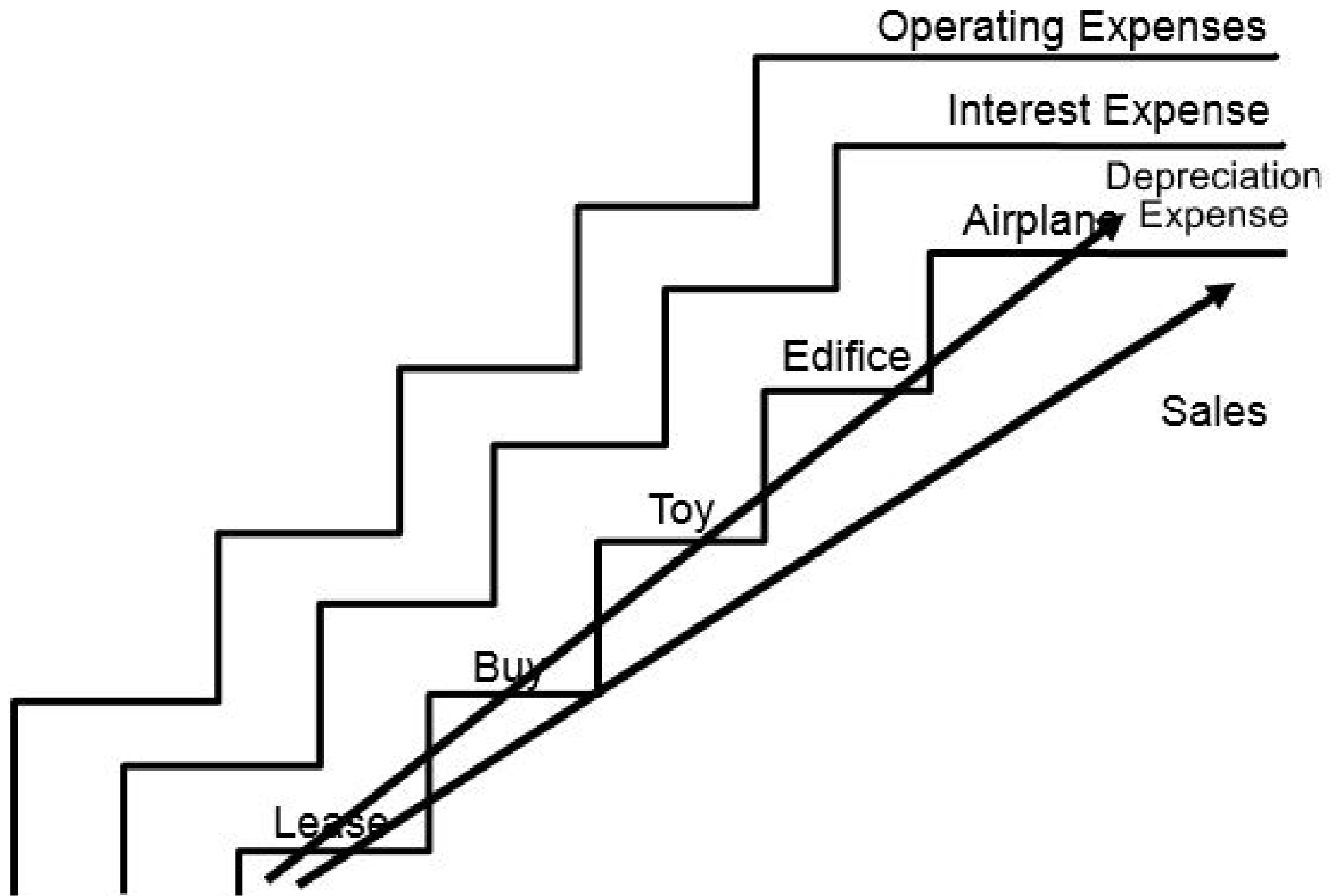
Change in Accounting Treatment of Operating Leases

- ❖ Lessee Financial Leverage/Debt Service Coverage
- ❖ Underwriting Guidelines
- ❖ Lease Terms/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
 - Breakeven Rental Rate
 - Breakeven Debt Service Coverage
 - Loan to Value
 - Liquidity/Financial Leverage
 - Ability to Refinance Maturing Debt

Potential Problem Sponsors



Borrower/Sponsor Liquidity and Capital
are Critical in the Current Lending
Environment

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

Cont.

- ❖ Portfolio Stress Testing
 - Loan Demand
 - Net Interest Margin
 - Portfolio Credit Quality - Criticized/Classified
 - Earnings
 - Capital

Most Loan Losses Incurred by Banks are
on Loans Made in the Last Two Years of a
Recovery

Steps Your Bank Should be Taking Now

- ❖ Identify Portfolio Concentrations e.g., Borrower and 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 and Contagion

Steps Your Bank Should be Taking Now

cont.

- ❖ Evaluate the Direct, Indirect and Contingent Liabilities of Larger Borrowers
- ❖ Assess the Global Cash Flow, Leverage, and Liquidity of Larger Borrowers
- ❖ Stress Test All Larger Borrowers in the Lowest Two Pass Categories in Your Bank's AQR Framework

Steps your Bank should be Taking Now

cont.

- ❖ 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

Questions?