

# Strategies for Success



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## Overview

- Risk Management Regulations
- Guidance
- Current Issues
- Compliance Regulations



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## Regulations

### Appraisal –

<http://www.fdic.gov/regulations/laws/rules/2000-4300.html>

- All real estate transactions > \$250M
- Excluded - Business transactions < \$1MM where repayment is not dependent on income from the lease or sale of property.

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## Guidance

### Interagency Appraisal and Evaluation Guidelines -

<http://www.fdic.gov/regulations/laws/rules/5000-4800.html#5000interagencyaae>

- Board approved appraisal and evaluation program
  - Appraisal versus evaluation
- Independence of the appraisal and evaluation function
- Portfolio Monitoring –
  - Criteria for obtaining reappraisals or reevaluations as part of a program of prudent portfolio review and monitoring techniques - even when additional financing is not being contemplated.

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## Regulations

### Lending Standards -

<http://www.fdic.gov/regulations/laws/rules/2000-8700.html>

- (a) Adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.
- (b)(1) Real estate lending policies adopted pursuant to this section must:
  - (i) Be consistent with safe and sound banking practices;
  - (ii) Be appropriate to the size of the institution and the nature and scope of its operations; and
  - (iii) Be reviewed and approved by the bank's board of directors at least annually.
- (2) The lending policies must establish:
  - (i) Loan portfolio diversification standards;
  - (ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;
  - (iii) Loan administration procedures for the bank's real estate portfolio; and
  - (iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.
- (c) Each insured state nonmember bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.
- (d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the federal bank and thrift supervisory agencies.

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## Guidance

- **Interagency Guidelines for Real Estate Lending Policies** <http://www.fdic.gov/regulations/laws/rules/2000-8700.html#2000appendixatopart365>
- Loan Portfolio Management Considerations
- Underwriting Standards
- Loan Administration
- Supervisory LTV Limits
- Loans in Excess of Supervisory LTV Limits
  - All RE loans less than 100% of total capital
  - Other than 1-4 family residential loans – 30% of total capital

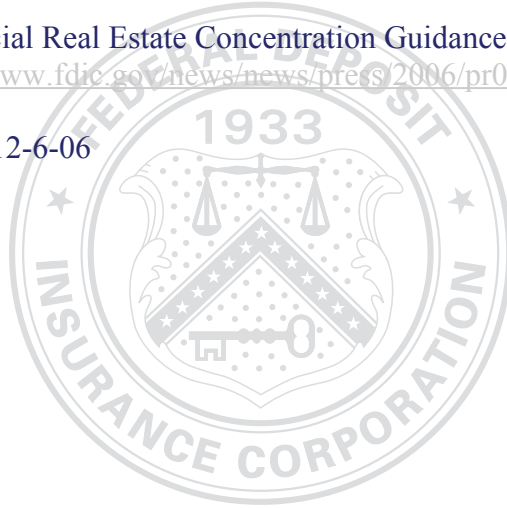
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## Guidance

### Commercial Real Estate Concentration Guidance -

<http://www.fdic.gov/news/news/press/2006/pr06114a.pdf>

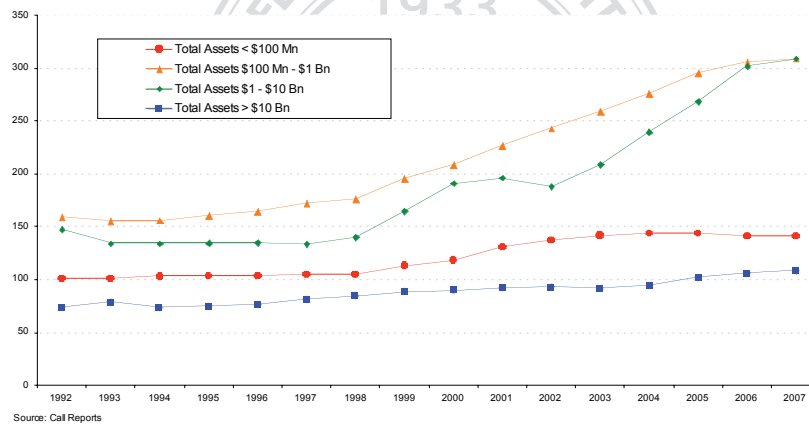
- Issued 12-6-06



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## Why New CRE Concentration Guidance?

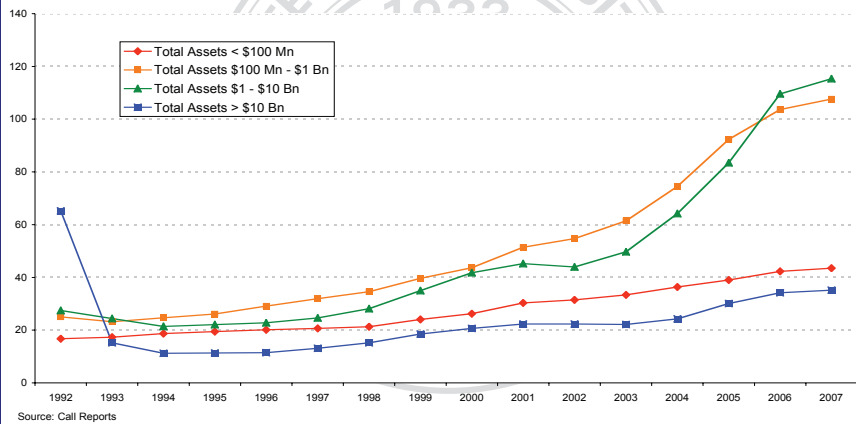
### Trends in CRE Concentrations by Asset Size (All Commercial and Savings Banks) (Total CRE Loans/Total Risk Based Capital)



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## Why New CRE Concentration Guidance?

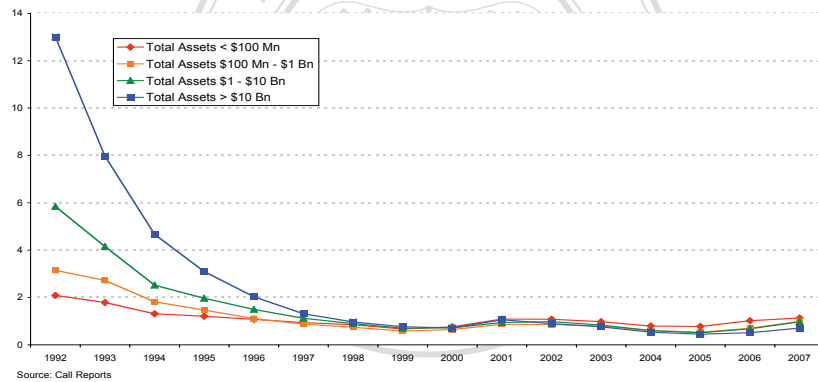
**Trends in C&D Concentrations by Asset Size**  
 (All Commercial and Savings Banks)  
 (Total C&D Loans/Total Risk Based Capital)



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## Still Performing?

**Trends in noncurrent CRE loans by Asset Size**  
 (All Commercial and Savings Banks)  
 (Total noncurrent CRE loans/Total CRE loans)



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## What is a CRE Concentration?

Per the Guidance – **Indicators** of a concentration

- Total CRE of 300% or more of total capital; **and** the outstanding balance of CRE loans has increased 50% or more in the last 36 months
- Total ADC of 100% or more of total capital
- Safe Harbors - No

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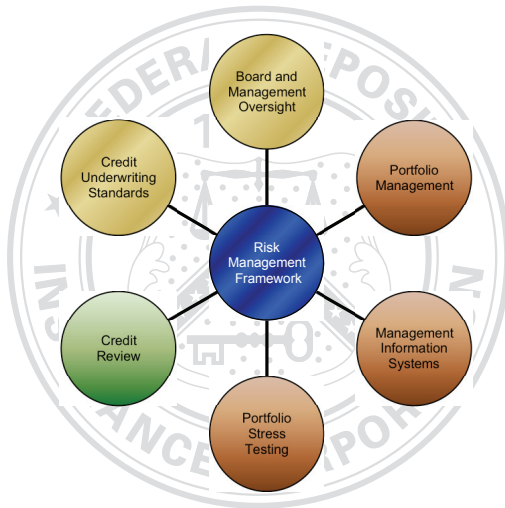
## What is a CRE Concentration?

Per the Institution – **Varies**

- **Segmentation**
  - Product
  - Geographic location
  - Single name

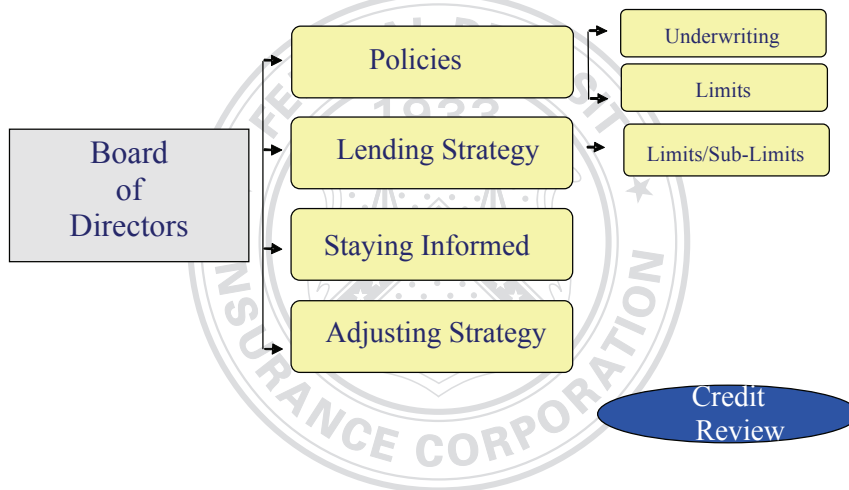
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## CRE Risk Management Framework



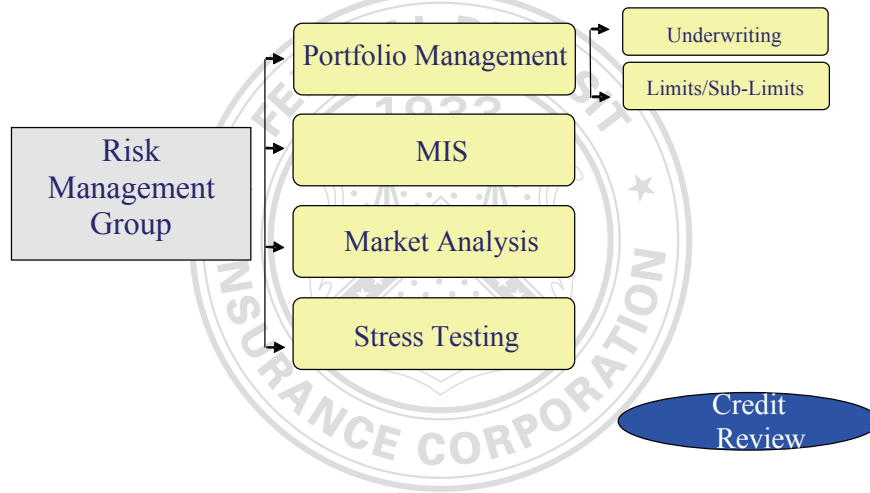
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## CRE Risk Management



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## CRE Risk Management



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## Managing High CRE Concentrations

- Raise underwriting standards
- Sell participations
- Sell whole loans
- Securitize deals – CMBS – stabilized properties
- Purchase credit protection
- Encourage weaker borrowers to refinance
- Curtail lending to all customers

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## Ways to Improve

- Underwriting
  - Resist the urge to be an asset-based lender
  - Analyze global cash flows
  - Critically review appraisals and their assumptions
- Loan Administration
  - Conduct inspections prior to releasing draws
- Portfolio Monitoring
  - Collect better front-end MIS data
  - Document market monitoring better
  - Collect market data at granular levels
  - Ensure all parties – management/lending staff are informed
  - Comply with internal limits
  - Maintain single name exposure concentrations at more manageable levels
  - Conduct portfolio stress testing

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## Key Takeaways

- CRE markets are cyclical
- CRE concentration levels are increasing
- Underwriting at origination should reflect possibility of a downturn
- Appraisal assumptions should be reviewed critically, especially in the case of primary asset-based lenders
- CRE guidance is intended to reiterate what banks should be doing anyway
- Some level of stress testing should be conducted

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## Compliance Management System (CMS)

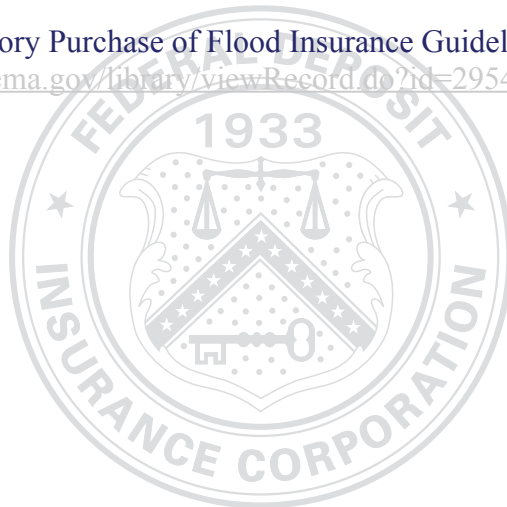
- Critical to include construction lending program
  - Board and Management Oversight
  - Compliance Program
  - Audit



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## Flood Insurance

- Mandatory Purchase of Flood Insurance Guidelines - [www.fema.gov/library/viewRecord.do?id=2954](http://www.fema.gov/library/viewRecord.do?id=2954)



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## Real Estate Settlement Procedures

- Reg X 3500.5(b)(3)- exemption for temporary financing. But exemption does not apply:
  - Construction loan that may be used as or converted to permanent financing by the same lender OR
  - Used to finance transfer of title to the first user (means financing the purchase of the land on which the construction will occur)
  - Business purpose transaction is exempt under 3500.5(b)(2)

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## Home Mortgage Disclosure

- Home Mortgage Disclosure – [www.ftfc.gov](http://www.ftfc.gov)
- **When is a loan "temporary financing" such that it is exempt from reporting?**
- **Answer:** The regulation lists as examples of temporary financing construction loans and bridge loans. See 203.4(d)(3). Construction and bridge loans are illustrative, not exclusive, examples of temporary financing. The examples indicate that financing is temporary if it is designed to be replaced by permanent financing of a much longer term.

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