

AMERICAN BANKER

On Focus and In Depth

Viewpoint: Get Aggressive with Bad CRE Loans

American Banker | Thursday, February 18, 2010

By Joseph Ori

Many commercial banks are having significant issues in dealing with their commercial real estate portfolios. Many loans are in default, are nonperforming or the market value of the asset is less than the loan balance. Last year the accounting rulemakers suspended the mark-to-market rule for commercial banks and the FDIC promulgated new rules for commercial real estate loans that allow banks to keep a loan as performing even though the value of the property is less than the loan balance.

The current balance of commercial real estate loans held by commercial banks and in commercial-mortgage-backed security pools is approximately \$1.45 trillion. It is widely agreed that the value of commercial property has fallen approximately 50% from its peak of three years ago. Assuming that the \$1.45 trillion loan balance represents a 75% loan to original value, then the mark-to-market value of commercial real estate loans is approximately \$967 billion, or a discount of \$483 billion. A markdown of this magnitude would be disastrous for many institutions and the whole banking industry.

However, many banks are missing an opportunity to be aggressive and deal with distressed commercial real estate loans.

A bank has three main options when it comes to troubled commercial real estate loans: restructure the loan with the borrower, sell the loan in the market or foreclose on the real estate and dispose of the real estate collateral.

Many banks have not pursued the above three options but have instead been in a state of denial about their commercial real estate problems. Banks need to be more aggressive to achieve the highest return on these troubled assets while at the same time protecting their capital ratios and balance sheet. First, they should meet with the borrower and explore ways to restructure the loan, including lowering the interest rate, extending the maturity date or waiving some restrictive loan covenants. I have talked to many colleagues who own commercial real estate, and it is amazing how many have not heard from or spoken with their lender about ways to restructure their loans or head off a looming default issue. One company in particular developed a small office condominium building in California that went into default when the units didn't sell.

The lender, a small community bank, has not corresponded with the borrower for months.

A number of banks have extended loan maturity dates for defaulted loans, but this has mostly been done to defer the problem loan to the next quarter. This practice, known as "Extend and Pretend" or "Pray and Delay," has been heavily criticized by the real estate market and is not a proactive approach to dealing with troubled loans.

Second, the bank should look to sell the loan or allow the borrower to pay it off at some discount. If the bank determines that the project is not performing then it can easily sell the loan via a third-party broker or through a sealed-bid auction with an established auction firm. A sealed-bid auction may be the best sales method to achieve the desired sales value. The sealed-bid auction option works great for pools of performing or nonperforming loans or equity assets with an established auction platform, national marketing, sealed-bid negotiation technique, sales transparency and expedient sales process. Many borrowers would jump at the chance to repay their loan at a discount assuming they could obtain a new loan and/or additional equity dollars. A discounted payoff would lower the debt level and debt service and potentially increase the property equity for the borrower.

And finally, if the loan is in default and the value of the asset is less than the loan balance, the bank should foreclose on the property and dispose of the asset. This will help the local economy by clearing the market of troubled properties. The foreclosure option is of course dependent on the bank's capital ratios and overall financial stability. It may cause some capital pain in the short term, but it will create a healthier bank balance sheet in the long term.

Many banks are uncertain as to what to do with their commercial real estate portfolios. Whether the portfolios are performing or nonperforming, banks need to take a proactive approach and either restructure the loan, sell the loan or foreclose and liquidate the asset. The bank will be better off in the long run and will return to profitability faster.

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| Year | Q1 | Q2 | Q3 | Q4 | Annual |
|------|------|------|------|------|--------|
| 2009 | 1.2 | 1.5 | 1.8 | 2.1 | 1.65 |
| 2008 | 1.5 | 1.8 | 2.1 | 2.4 | 1.95 |
| 2007 | 1.8 | 2.1 | 2.4 | 2.7 | 2.25 |
| 2006 | 2.1 | 2.4 | 2.7 | 3.0 | 2.55 |
| 2005 | 2.4 | 2.7 | 3.0 | 3.3 | 2.85 |
| 2004 | 2.7 | 3.0 | 3.3 | 3.6 | 3.15 |
| 2003 | 3.0 | 3.3 | 3.6 | 3.9 | 3.45 |
| 2002 | 3.3 | 3.6 | 3.9 | 4.2 | 3.75 |
| 2001 | 3.6 | 3.9 | 4.2 | 4.5 | 4.05 |
| 2000 | 3.9 | 4.2 | 4.5 | 4.8 | 4.35 |
| 1999 | 4.2 | 4.5 | 4.8 | 5.1 | 4.65 |
| 1998 | 4.5 | 4.8 | 5.1 | 5.4 | 4.95 |
| 1997 | 4.8 | 5.1 | 5.4 | 5.7 | 5.25 |
| 1996 | 5.1 | 5.4 | 5.7 | 6.0 | 5.55 |
| 1995 | 5.4 | 5.7 | 6.0 | 6.3 | 5.85 |
| 1994 | 5.7 | 6.0 | 6.3 | 6.6 | 6.15 |
| 1993 | 6.0 | 6.3 | 6.6 | 6.9 | 6.45 |
| 1992 | 6.3 | 6.6 | 6.9 | 7.2 | 6.75 |
| 1991 | 6.6 | 6.9 | 7.2 | 7.5 | 7.05 |
| 1990 | 6.9 | 7.2 | 7.5 | 7.8 | 7.35 |
| 1989 | 7.2 | 7.5 | 7.8 | 8.1 | 7.65 |
| 1988 | 7.5 | 7.8 | 8.1 | 8.4 | 7.95 |
| 1987 | 7.8 | 8.1 | 8.4 | 8.7 | 8.25 |
| 1986 | 8.1 | 8.4 | 8.7 | 9.0 | 8.55 |
| 1985 | 8.4 | 8.7 | 9.0 | 9.3 | 8.85 |
| 1984 | 8.7 | 9.0 | 9.3 | 9.6 | 9.15 |
| 1983 | 9.0 | 9.3 | 9.6 | 9.9 | 9.45 |
| 1982 | 9.3 | 9.6 | 9.9 | 10.2 | 9.75 |
| 1981 | 9.6 | 9.9 | 10.2 | 10.5 | 10.05 |
| 1980 | 9.9 | 10.2 | 10.5 | 10.8 | 10.35 |
| 1979 | 10.2 | 10.5 | 10.8 | 11.1 | 10.65 |
| 1978 | 10.5 | 10.8 | 11.1 | 11.4 | 10.95 |
| 1977 | 10.8 | 11.1 | 11.4 | 11.7 | 11.25 |
| 1976 | 11.1 | 11.4 | 11.7 | 12.0 | 11.55 |
| 1975 | 11.4 | 11.7 | 12.0 | 12.3 | 11.85 |
| 1974 | 11.7 | 12.0 | 12.3 | 12.6 | 12.15 |
| 1973 | 12.0 | 12.3 | 12.6 | 12.9 | 12.45 |
| 1972 | 12.3 | 12.6 | 12.9 | 13.2 | 12.75 |
| 1971 | 12.6 | 12.9 | 13.2 | 13.5 | 13.05 |
| 1970 | 12.9 | 13.2 | 13.5 | 13.8 | 13.35 |
| 1969 | 13.2 | 13.5 | 13.8 | 14.1 | 13.65 |
| 1968 | 13.5 | 13.8 | 14.1 | 14.4 | 13.95 |
| 1967 | 13.8 | 14.1 | 14.4 | 14.7 | 14.25 |
| 1966 | 14.1 | 14.4 | 14.7 | 15.0 | 14.55 |
| 1965 | 14.4 | 14.7 | 15.0 | 15.3 | 14.85 |
| 1964 | 14.7 | 15.0 | 15.3 | 15.6 | 15.15 |
| 1963 | 15.0 | 15.3 | 15.6 | 15.9 | 15.45 |
| 1962 | 15.3 | 15.6 | 15.9 | 16.2 | 15.75 |
| 1961 | 15.6 | 15.9 | 16.2 | 16.5 | 16.05 |
| 1960 | 15.9 | 16.2 | 16.5 | 16.8 | 16.35 |
| 1959 | 16.2 | 16.5 | 16.8 | 17.1 | 16.65 |
| 1958 | 16.5 | 16.8 | 17.1 | 17.4 | 16.95 |
| 1957 | 16.8 | 17.1 | 17.4 | 17.7 | 17.25 |
| 1956 | 17.1 | 17.4 | 17.7 | 18.0 | 17.55 |
| 1955 | 17.4 | 17.7 | 18.0 | 18.3 | 17.85 |
| 1954 | 17.7 | 18.0 | 18.3 | 18.6 | 18.15 |
| 1953 | 18.0 | 18.3 | 18.6 | 18.9 | 18.45 |
| 1952 | 18.3 | 18.6 | 18.9 | 19.2 | 18.75 |
| 1951 | 18.6 | 18.9 | 19.2 | 19.5 | 19.05 |
| 1950 | 18.9 | 19.2 | 19.5 | 19.8 | 19.35 |
| 1949 | 19.2 | 19.5 | 19.8 | 20.1 | 19.65 |
| 1948 | 19.5 | 19.8 | 20.1 | 20.4 | 19.95 |
| 1947 | 19.8 | 20.1 | 20.4 | 20.7 | 20.25 |
| 1946 | 20.1 | 20.4 | 20.7 | 21.0 | 20.55 |
| 1945 | 20.4 | 20.7 | 21.0 | 21.3 | 20.85 |
| 1944 | 20.7 | 21.0 | 21.3 | 21.6 | 21.15 |
| 1943 | 21.0 | 21.3 | 21.6 | 21.9 | 21.45 |
| 1942 | 21.3 | 21.6 | 21.9 | 22.2 | 21.75 |
| 1941 | 21.6 | 21.9 | 22.2 | 22.5 | 22.05 |
| 1940 | 21.9 | 22.2 | 22.5 | 22.8 | 22.35 |
| 1939 | 22.2 | 22.5 | 22.8 | 23.1 | 22.65 |
| 1938 | 22.5 | 22.8 | 23.1 | 23.4 | 22.95 |
| 1937 | 22.8 | 23.1 | 23.4 | 23.7 | 23.25 |
| 1936 | 23.1 | 23.4 | 23.7 | 24.0 | 23.55 |
| 1935 | 23.4 | 23.7 | 24.0 | 24.3 | 23.85 |
| 1934 | 23.7 | 24.0 | 24.3 | 24.6 | 24.15 |
| 1933 | 24.0 | 24.3 | 24.6 | 24.9 | 24.45 |
| 1932 | 24.3 | 24.6 | 24.9 | 25.2 | 24.75 |
| 1931 | 24.6 | 24.9 | 25.2 | 25.5 | 25.05 |
| 1930 | 24.9 | 25.2 | 25.5 | 25.8 | 25.35 |
| 1929 | 25.2 | 25.5 | 25.8 | 26.1 | 25.65 |
| 1928 | 25.5 | 25.8 | 26.1 | 26.4 | 25.95 |
| 1927 | 25.8 | 26.1 | 26.4 | 26.7 | 26.25 |
| 1926 | 26.1 | 26.4 | 26.7 | 27.0 | 26.55 |
| 1925 | 26.4 | 26.7 | 27.0 | 27.3 | 26.85 |
| 1924 | 26.7 | 27.0 | 27.3 | 27.6 | 27.15 |
| 1923 | 27.0 | 27.3 | 27.6 | 27.9 | 27.45 |
| 1922 | 27.3 | 27.6 | 27.9 | 28.2 | 27.75 |
| 1921 | 27.6 | 27.9 | 28.2 | 28.5 | 28.05 |
| 1920 | 27.9 | 28.2 | 28.5 | 28.8 | 28.35 |
| 1919 | 28.2 | 28.5 | 28.8 | 29.1 | 28.65 |
| 1918 | 28.5 | 28.8 | 29.1 | 29.4 | 28.95 |
| 1917 | 28.8 | 29.1 | 29.4 | 29.7 | 29.25 |
| 1916 | 29.1 | 29.4 | 29.7 | 30.0 | 29.55 |
| 1915 | 29.4 | 29.7 | 30.0 | 30.3 | 29.85 |
| 1914 | 29.7 | 30.0 | 30.3 | 30.6 | 30.15 |
| 1913 | 30.0 | 30.3 | 30.6 | 30.9 | 30.45 |
| 1912 | 30.3 | 30.6 | 30.9 | 31.2 | 30.75 |
| 1911 | 30.6 | 30.9 | 31.2 | 31.5 | 31.05 |
| 1910 | 30.9 | 31.2 | 31.5 | 31.8 | 31.35 |
| 1909 | 31.2 | 31.5 | 31.8 | 32.1 | 31.65 |
| 1908 | 31.5 | 31.8 | 32.1 | 32.4 | 31.95 |
| 1907 | 31.8 | 32.1 | 32.4 | 32.7 | 32.25 |
| 1906 | 32.1 | 32.4 | 32.7 | 33.0 | 32.55 |
| 1905 | 32.4 | 32.7 | 33.0 | 33.3 | 32.85 |
| 1904 | 32.7 | 33.0 | 33.3 | 33.6 | 33.15 |
| 1903 | 33.0 | 33.3 | 33.6 | 33.9 | 33.45 |
| 1902 | 33.3 | 33.6 | 33.9 | 34.2 | 33.75 |
| 1901 | 33.6 | 33.9 | 34.2 | 34.5 | 34.05 |
| 1900 | 33.9 | 34.2 | 34.5 | 34.8 | 34.35 |
| 1899 | 34.2 | 34.5 | 34.8 | 35.1 | 34.65 |
| 1898 | 34.5 | 34.8 | 35.1 | 35.4 | 34.95 |
| 1897 | 34.8 | 35.1 | 35.4 | 35.7 | 35.25 |
| 1896 | 35.1 | 35.4 | 35.7 | 36.0 | 35.55 |
| 1895 | 35.4 | 35.7 | 36.0 | 36.3 | 35.85 |
| 1894 | 35.7 | 36.0 | 36.3 | 36.6 | 36.15 |
| 1893 | 36.0 | 36.3 | 36.6 | 36.9 | 36.45 |
| 1892 | 36.3 | 36.6 | 36.9 | 37.2 | 36.75 |
| 1891 | 36.6 | 36.9 | 37.2 | 37.5 | 37.05 |
| 1890 | 36.9 | 37.2 | 37.5 | 37.8 | 37.35 |
| 1889 | 37.2 | 37.5 | 37.8 | 38.1 | 37.65 |
| 1888 | 37.5 | 37.8 | 38.1 | 38.4 | 37.95 |
| 1887 | 37.8 | 38.1 | 38.4 | 38.7 | 38.25 |
| 1886 | 38.1 | 38.4 | 38.7 | 39.0 | 38.55 |
| 1885 | 38.4 | 38.7 | 39.0 | 39.3 | 38.85 |
| 1884 | 38.7 | 39.0 | 39.3 | 39.6 | 39.15 |
| 1883 | 39.0 | 39.3 | 39.6 | 39.9 | 39.45 |
| 1882 | 39.3 | 39.6 | 39.9 | 40.2 | 39.75 |
| 1881 | 39.6 | 39.9 | 40.2 | 40.5 | 40.05 |
| 1880 | 39.9 | 40.2 | 40.5 | 40.8 | 40.35 |
| 1879 | 40.2 | 40.5 | 40.8 | 41.1 | 40.65 |
| 1878 | 40.5 | 40.8 | 41.1 | 41.4 | 40.95 |
| 1877 | 40.8 | 41.1 | 41.4 | 41.7 | 41.25 |
| 1876 | 41.1 | 41.4 | 41.7 | 42.0 | 41.55 |
| 1875 | 41.4 | 41.7 | 42.0 | 42.3 | 41.85 |
| 1874 | 41.7 | 42.0 | 42.3 | 42.6 | 42.15 |
| 1873 | 42.0 | 42.3 | 42.6 | 42.9 | 42.45 |
| 1872 | 42.3 | 42.6 | 42.9 | 43.2 | 42.75 |
| 1871 | 42.6 | 42.9 | 43.2 | 43.5 | 43.05 |
| 1870 | 42.9 | 43.2 | 43.5 | 43.8 | 43.35 |
| 1869 | 43.2 | 43.5 | 43.8 | 44.1 | 43.65 |
| 1868 | 43.5 | 43.8 | 44.1 | 44.4 | 43.95 |
| 1867 | 43.8 | 44.1 | 44.4 | 44.7 | 44.25 |
| 1866 | 44.1 | 44.4 | 44.7 | 45.0 | 44.55 |
| 1865 | 44.4 | 44.7 | 45.0 | 45.3 | 44.85 |
| 1864 | 44.7 | 45.0 | 45.3 | 45.6 | 45.15 |
| 1863 | 45.0 | 45.3 | 45.6 | 45.9 | 45.45 |
| 1862 | 45.3 | 45.6 | 45.9 | 46.2 | 45.75 |
| 1861 | 45.6 | 45.9 | 46.2 | 46.5 | 46.05 |
| 1860 | 45.9 | 46.2 | 46.5 | 46.8 | 46.35 |
| 1859 | 46.2 | 46.5 | 46.8 | 47.1 | 46.65 |
| 1858 | 46.5 | 46.8 | 47.1 | 47.4 | 46.95 |
| 1857 | 46.8 | 47.1 | 47.4 | 47.7 | 47.25 |
| 1856 | 47.1 | 47.4 | 47.7 | 48.0 | 47.55 |
| 1855 | 47.4 | 47.7 | 48.0 | 48.3 | 47.85 |
| 1854 | 47.7 | 48.0 | 48.3 | 48.6 | 48.15 |
| 1853 | 48.0 | 48.3 | 48.6 | 48.9 | 48.45 |
| 1852 | 48.3 | 48.6 | 48.9 | 49.2 | 48.75 |
| 1851 | 48.6 | 48.9 | 49.2 | 49.5 | 49.05 |
| 1850 | 48.9 | 49.2 | 49.5 | 49.8 | 49.35 |
| 1849 | 49.2 | 49.5 | 49.8 | 50.1 | 49.65 |
| 1848 | 49.5 | 49.8 | 50.1 | 50.4 | 49.95 |
| 1847 | 49.8 | 50.1 | 50.4 | 50.7 | 50.25 |
| 1846 | 50.1 | 50.4 | 50.7 | 51.0 | 50.55 |
| 1845 | 50.4 | 50.7 | 51.0 | 51.3 | 50.85 |
| 1844 | 50.7 | 51.0 | 51.3 | 51.6 | 51.15 |
| 1843 | 51.0 | 51.3 | 51.6 | 51.9 | 51.45 |
| 1842 | 51.3 | 51.6 | 51.9 | 52.2 | 51.75 |
| 1841 | 51.6 | 51.9 | 52.2 | 52.5 | 52.05 |
| 1840 | 51.9 | 52.2 | 52.5 | 52.8 | 52.35 |
| 1839 | 52.2 | 52.5 | 52.8 | 53.1 | 52.65 |
| 1838 | 52.5 | 52.8 | 53.1 | 53.4 | 52.95 |
| 1837 | 52.8 | 53.1 | 53.4 | 53.7 | 53.25 |
| 1836 | 53.1 | 53.4 | 53.7 | 54.0 | 53.55 |
| 1835 | 53.4 | 53.7 | 54.0 | 54.3 | 53.85 |
| 1834 | 53.7 | 54.0 | 54.3 | 54.6 | 54.15 |
| 1833 | 54.0 | 54.3 | 54.6 | 54.9 | 54.45 |
| 1832 | 54.3 | 54.6 | 54.9 | 55.2 | 54.75 |
| 1831 | 54.6 | 54.9 | 55.2 | 55.5 | 55.05 |
| 1830 | 54.9 | 55.2 | 55.5 | 55.8 | 55.35 |
| 1829 | 55.2 | 55.5 | 55.8 | 56.1 | 55.65 |
| 1828 | 55.5 | 55.8 | 56.1 | 56.4 | 55.95 |
| 1827 | 55.8 | 56.1 | 56.4 | 56.7 | 56.25 |
| 1826 | 56.1 | 56.4 | 56.7 | 57.0 | 56.55 |
| 1825 | 56.4 | 56.7 | 57.0 | 57.3 | 56.85 |
| 1824 | 56.7 | 57.0 | 57.3 | 57.6 | 57.15 |
| 1823 | 57.0 | 57.3 | 57.6 | 57.9 | 57.45 |
| 1822 | 57.3 | 57.6 | 57.9 | 58.2 | 57.75 |
| 1821 | 57.6 | 57.9 | 58.2 | 58.5 | 58.05 |
| 1820 | 57.9 | 58.2 | 58.5 | 58.8 | 58.35 |
| 1819 | 58.2 | 58.5 | 58.8 | 59.1 | 58.65 |
| 1818 | 58.5 | 58.8 | 59.1 | 59.4 | 58.95 |
| 1817 | 58.8 | 59.1 | 59.4 | 59.7 | 59.25 |
| 1816 | 59.1 | 59.4 | 59.7 | 60.0 | 59.55 |
| 1815 | 59.4 | 59.7 | 60.0 | 60.3 | 59.85 |
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| 1809 | 61.2 | 61.5 | 61.8 | 62.1 | 61.65 |
| 1808 | 61.5 | 61.8 | 62.1 | 62.4 | 61.95 |
| 1807 | 61.8 | 62.1 | 62.4 | 62.7 | 62.25 |
| 1806 | 62.1 | 62.4 | 62.7 | 63.0 | 62.55 |