Federal Bank Regulators Issue Policy Statement on Prudent Commercial Real Estate Loan Accommodations

Banking Brief: Financial Services Insights

By Keith Mundrick on July 17, 2023

Since early 2023, there has been consistent reporting of possible turbulence and increased default risk relating to commercial real estate loans. These concerns are driven by historic levels of maturing debt, which is in many cases secured by real estate that has taken a sharp hit in value. Roughly $2.5 trillion in commercial real estate debt is set to mature in the next five years—more than any other five-year period in history. Meanwhile, interest rates have risen dramatically and occupancies have plummeted in many commercial real estate segments. These loans present a looming challenge for many banks and borrowers.

This past week, the OCC, FDIC, NCUA, and Federal Reserve adopted a Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts, available here. The Statement is applicable to all supervised financial institutions engaged in commercial real estate lending, and discusses the importance of working constructively with commercial real estate borrowers who may be experiencing financial difficulty.

The last time such a Statement was issued was in 2009 in the aftermath of the last financial crisis. While the new 2023 Policy Statement was first published for comment in the third quarter of 2022, its formal adoption this summer is timely.

The 2023 Statement supersedes and replaces the 2009 Statement, while bolstering and reaffirming two key principles. First, financial institutions that implement prudent commercial real estate loan accommodation and workout arrangements after performing a comprehensive review of a borrower's financial condition will not be subject to criticism for engaging in these efforts, even if these arrangements result in modified loans with weaknesses that result in adverse classification. Second, modified loans to borrowers who have the ability to repay their debts according to reasonable terms will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that is less than the outstanding loan balance.

Compared to the 2009 Statement, the 2023 Statement includes: (1) an addition of a new section on short-term loan accommodations; (2) new information about changes in accounting principles since 2009; and (3) revisions and additions to examples of commercial real estate loan workouts.

As a potential storm continues to brew in the commercial real estate markets, federal regulators seem to be signaling to banks that they will be supported in accommodating otherwise strong borrowers who are caught up in larger market forces; however, banks need to carefully document in detail the business prudence of the commercial real estate loan accommodations and workout arrangements and the detail and results of the steps taken during the comprehensive review of the borrower's financial condition.