



at current or as-is value. The treatment is suspiciously close to the pro-forma lending practices that bankers embraced during the go-go days, now viewed with askance. “It is interesting. The guidelines suggest that it is possible to restructure a loan based on expectations of future property performance,” said Gregg J. Loubier, a partner and expert on real estate finance with law firm Allen Matkins. “Lenders have been roundly criticized for making loans in the recent past based on what many people believed were optimistic assumptions about leasing expectations that in many cases have not materialized.”

Loans also can be considered performing even if the collateral value has fallen below the loan balance. That was not true in the past, said Richard Caldwell, former chief credit officer at Pacific National.

“It’s not carte blanche to keep everything in the performing category, but it’s very much distinct from the current regulation, a material deviation, in my view,” he said. “Banks were not able to keep overleveraged loans in the performing category in the past. It affects their loan-loss reserves.”

The guidance helps banks to minimize required loan-loss reserves in other ways, too. “Historically, bank examiners didn’t look at [borrowers’] global cash flows available to repay debt. So if a borrower were repaying with something other than the cash flow from the asset, the loan was non-performing,” said Michel Kapulica, a partner in Assurance and Advisory Business Services for Ernst & Young LLP in San Francisco. The new guidance lets lenders determine if a loan is recoverable based on borrowers’ general ability to pay and to classify the loan accordingly.

The guidance also encourages lenders to divide troubled loans into A and B pieces, which also cuts required loan-loss reserves. If a borrower

is able to service a portion of the debt, that piece would continue to be considered fit, while only the B piece would be classified as troubled debt, Kapulica said

Still, he and others are not convinced the changes will much prevent the distress from seeping in. “A large number of borrowers just don’t have the global strength to pay on over-leveraged deals,” he said.

Researchers at Deutsche Bank also predict that the worst is yet to come. “... [Commercial real estate] exposures will lead to hundreds of billions of dollars in real losses and many hundreds of [bank] failures,” Richard Parkus, the bank’s head of commercial real estate debt research, forecast this fall. U.S. banks are exposed to \$1.81 trillion in construction, land development, core property and multifamily real estate loans. The largest group of banks, those with assets of \$25 billion or less, are most at risk. They are heavily exposed to construction loans, half of which are expected to default. They also have failed to set aside sufficient loan-loss reserves. As to the theory (or hope) that time will reduce pain, Deutsche Bank is dubious: “Improvements in rents and vacancy rates are also extremely unlikely to be sufficient to materially affect the scope of the problems.”

For Joseph Franzetti, managing director of debt advisory services for Cohen Financial in Chicago, now may be the deceptive calm before the storm. Franzetti works for commercial property owners to restructure and modify existing debt. Servicers in the commercial mortgage-backed securities market are overwhelmed, he said. Bankers are next, he believes. “You can try to kick the can down the road, but if a loan has real cash-flow problems, it’s hard to run away from those.”

Losses, he said, are real losses. ■

