

Large Portion of Bank Loans Backed by Commercial Real Estate Are Not CRE Loans

Bank call reports have always been an unreliable estimate of the amount of income-producing commercial real estate loans in bank portfolios because the reports included owner-occupied property loans that were largely operating company loans secured by real estate. The degree of that overstatement is only now coming to light with the release of the latest call reports. Based on the reports of ten representative banks, only 52 percent of reported nonfarm nonresidential real estate loans are income property loans.¹

The new data by the Federal Financial Institutions Examination Council (FFIEC) details for the first time the shares of banks' commercial real estate mortgage portfolios that are backed by income-producing properties and the shares that are backed by owner-occupied commercial properties.

The Distinction

The distinction is important because of differences in the ways the two types of loans are underwritten. A loan backed by an income-producing property relies on the performance of that property for the repayment of the loan. The loan is underwritten based on the ability of future property revenues (in the form of rent and lease payments) to cover both future property expenses (in the form of utilities, taxes, insurance and other property-specific costs) and the debt service of the loan (the monthly principal and/or interest payments).

1 Multifamily loans are included in regulatory and other definitions of income-producing property loans but are not included in these numbers covering nonfarm nonresidential property loans. Future MBA analysis will include multifamily loans.

A loan backed by an owner-occupied property, on the other hand, is essentially a business loan with additional collateral (the property) pledged as credit support. In this case, the loan is underwritten based on the ability of future business revenues (from the sales of goods or services) to cover both business expenses (including payroll, supplies and other general business expenses) and the debt service on the loan.

The differences in the two types of loans have been recognized for many years, and are manifest in recent regulatory actions – including guidance on commercial real estate (CRE) concentrations at commercial banks and proposed rules implementing Basel capital requirements. In the guidance on commercial real estate concentrations, for example, the definition of CRE loans explicitly excludes loans backed by owner-occupied properties.

The new data provides the first detailed assessment of the degree to which the loans that have traditionally been lumped together in banks' call reports fall into one group or the other. (More details will be rolled out over the coming year as the new reporting is fully implemented.)

Each Type Makes Up a Large Share of Bank Loan

Early, bank-level reports show that among the top ten commercial/multifamily bank lenders, the numbers of both income-producing and owner-occupied property loans are significant.

Looking just at the top ten lenders with loans backed by nonfarm nonresidential real estate, an aggregate of \$113 billion, or 52 percent of their portfolios, were backed by income-producing properties. The remaining \$102 billion, or 48 percent of their portfolios, were backed by owner-occupied properties.

Loans Secured by Nonfarm Nonresidential Properties (\$ Thousands), Q1 2007

Bank	Owner-occupied	Other	Total	Percent Owner-occupied
Bank of America	\$26,690,199	\$21,904,148	\$48,594,347	55%
Wachovia Bank	\$7,384,000	\$39,161,000	\$46,545,000	16%
Wells Fargo Bank	\$13,018,000	\$14,426,000	\$27,444,000	47%
JPMorgan Chase Bank	\$9,642,000	\$6,648,000	\$16,290,000	59%
U.S. Bank	\$7,441,225	\$8,245,932	\$15,687,157	47%
Regions Bank	\$10,685,456	\$4,011,743	\$14,697,199	73%
Branch Banking and Trust	\$6,494,721	\$6,001,322	\$12,496,043	52%
Comerica	\$9,335,416	\$2,663,098	\$11,998,514	78%
Suntrust	\$7,674,825	\$4,011,965	\$11,686,790	66%
Manufacturers and Traders Trust	\$4,367,090	\$6,128,266	\$10,495,356	42%
Total, Top 10 CRE Lending Banks	\$102,732,932	\$113,201,474	\$215,934,406	48%

Conclusion

More details on the full universe of commercial banks will be available with the release of additional FFIEC reports. MBA will provide analysis of the data as it becomes available. The data from the expanded reports will provide greater insights into the composition of the commercial/multifamily portfolios of commercial banks. In the context of regulators' recent attention to the commercial/multifamily mortgage market, the information provided will help paint a clearer picture of banks portfolios and any concentrations of risk that are (and are not) there.

Call Report Reporting

The agencies are phasing in breakdowns of the existing item for nonfarm nonresidential real estate loans through March 2008 according to bank size. Below are the long-standing definition of a real estate loan and the new instructions.

Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 031 and 041) Pages A-58 and RC-C-29

DEFINITION OF REAL ESTATE LOAN SECURED BY REAL ESTATE:

[A real estate loan] is a loan secured wholly or substantially by a lien on real property for which the lien is central to the extension of credit — that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien on real property... Only in transactions where a lien on real property has been taken as collateral solely through the abundance of caution and where the terms as a consequence have not been made more favorable than they would have been in the absence of the lien, would the loans not be considered to be secured by real estate and not be classifiable as loans secured by real estate in the Report of Condition.

“Loans secured by owner-occupied nonfarm nonresidential properties” are those nonfarm nonresidential property loans for which the primary source of repayment is the cash flow from the ongoing operations and activities conducted by the party, or an affiliate of the party, who owns the property. Thus, for loans secured by owner-occupied nonfarm nonresidential properties, the primary source of repayment is not derived from third party, nonaffiliated, rental income associated with the property (i.e., any such rental income is less than 50 percent of the source of repayment) or the proceeds of the sale, refinancing, or permanent financing of the property. Include loans secured by hospitals, golf courses, recreational facilities, and car washes unless the property is owned by an investor who leases the property to the operator who, in turn, is not related to or affiliated with the investor. Also include loans secured by churches unless the property is owned by an investor who leases the property to the congregation.

“Loans secured by other nonfarm nonresidential properties” are those nonfarm nonresidential property loans where the primary source of repayment is derived from rental income associated with the property (i.e., loans for which 50 percent or more of the source of repayment comes from third party, nonaffiliated, rental income) or the proceeds of the sale, refinancing, or permanent financing of the property. Include loans secured by hotels, motels, dormitories, nursing homes, assisted-living facilities, mini-storage warehouse facilities, and similar properties in this item as loans secured by other nonfarm nonresidential properties.

About PolicyNotes

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