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Plan Coming on Commercial Loans

By DAMIAN PALETTA

WASHINGTON -- Federal bank regulators are close to issuing guidelines that would encourage lenders to rework troubled commercial real-estate loans, a sector of the economy they expect to topple scores of additional financial institutions.

Federal Deposit Insurance Corp. Chairman Sheila Bair told a Senate subcommittee that reworking the terms of these loans could help banks avoid larger losses. She likened it to the push regulators made last year for banks to rework troubled residential mortgages.

Reworked commercial real estate loans "should be encouraged, not criticized," she said. "We are encouraging banks to restructure these loans."

The guidance comes as regulators are bracing for many more bank failures, particularly at small banks with high exposures to commercial real-estate loans. Commercial real-estate loans are the second-largest loan type after home mortgages. More than half of the $3.4 trillion in outstanding commercial real-estate debt is held by banks. Deutsche Bank AG has projected that commercial-real-estate losses for banks could end up being as high as $300 billion.

Ms. Bair said failures in 2010 would likely track the levels in 2009, which has seen 98 banks collapse so far. Federal Reserve Governor Daniel K. Tarullo said "banks are vulnerable to significant further deterioration in their CRE loans." Regulators said high levels of these loans are concentrated in smaller banks, although regional and large banks also have exposure to problems in these areas.

Mr. Tarullo said the types of loans causing the most problems are construction and development loans, not investments on existing properties. One reason: Construction and development loans are likely not bringing any income or revenue for the borrower, making it much easier to fall behind.

Officials at the hearing warned that despite evidence of some recovery in the economy, the performance of federally insured banks could remain sluggish. Mr. Tarullo said Fed data showed lending to households and nonfinancial businesses fell "sharply" in the third quarter of the year.

The regulators' comments come as banks begin releasing their earnings for the third quarter, which are expected to show an uneven performance, with strong banks bringing in robust earnings while struggling banks continue to slip.

—Lingling Wei contributed to this article.

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