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# Banks Get New Rules on Property

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Federal bank regulators issued guidelines allowing banks to keep loans on their books as "performing" even if the value of the underlying properties have fallen below the loan amount.

The volume of troubled commercial real-estate loans is skyrocketing. Regulators said that the rules were designed to encourage banks to restructure problem commercial mortgages with borrowers rather than foreclose on them. But the move has prompted criticism that regulators are simply prolonging the financial crisis by not forcing borrowers and lenders to confront, rather than delay, inevitable problems.

The guidelines, released on Friday by agencies including the Federal Deposit Insurance Corp., the Federal Reserve and the Office of the Comptroller of the Currency, provide guidance for bank examiners and financial institutions working with commercial property owners who are "experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties." Restructurings are often in the best interest of both lenders and borrowers, the guidelines point out.

The new rules don't reverse existing rules. Rather they are more explicit than regulators have been in the past about how banks should deal with restructuring issues. Banks in recent months have been peppering agencies with questions about this as the number of problem loans has soared.

Regulators have been expressing increasing concern that problems in commercial real estate could unglue the nascent economic recovery by slamming financial institutions with billions of dollars in new losses. FDIC Chairman Sheila Bair told a Senate subcommittee earlier this month 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.

About $770 billion of the $1.4 trillion commercial mortgages that will mature in the next five years are currently underwater, according to Foresight Analytics. As of last week, 106 banks had failed this year, the most since 1992—the peak of the savings-and-loan crisis. Regional and community banks especially have been paying dearly for their aggressive push into commercial real-estate lending during the boom years.

The new guidelines are targeted primarily at the hundreds of billions of dollars worth of loans that are coming due that can't be refinanced largely because the value of the properties have fallen below the loan amount. In many of these situations, the properties are still generating enough income to pay debt service.

Banks have generally been keeping a lid on commercial real-estate losses by extending these mortgages upon maturity. However, that practice, billed by many industry observers as "extending and pretending," has come under criticism by some analysts and investors as it promises to put off the pains into the future.

Now federal regulators are essentially sanctioning the practice as long as banks restructure loans prudently. The federal guidelines note that banks that conduct "prudent" loan workouts after looking at the borrower's financial condition "will not be subject to criticism (by regulators) for engaging in these efforts." In addition, loans to creditworthy borrowers that have been restructured and are current won't be reclassified as "high risk" by regulators solely because the collateral backing them has declined to an amount less than the loan balance, the new guidelines state.

Critics say the new rules are yet another example of a head-in-the-sand approach by regulators, pointing to the relaxed accounting standards last year that enabled banks to avoid marking the value of the loans down. This is doing long-term damage to the economy, they say, because it ties up bank capital, preventing them from resuming lending.

Critics say a wiser approach would be for regulators and banks to deal with problems quickly like the Resolution Trust Corp. did in the early 1990s during the last commercial real-estate crash. Back then, the RTC helped purge the financial system of toxic mortgages.

The new guidance "gives people a long time to figure out they're not going to pay it back," said Douglas Durst, a leading New York City developer. "We are in a period where nothing is happening," he said, adding that banks are "not making any new loans because they have this bad debt on their books and not writing it down and getting rid of it."

—Peter Grant and Damian Paletta contributed to this article

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