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Federal Guidelines Issued for Commercial Loan Modifications

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.

As reported in the Wall Street Journal (http://tinyurl.com/yes3jfk), 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.

Banks have generally been avoiding commercial real-estate losses by extending these mortgages upon maturity, a practice, billed by many industry observers as "extending and pretending."

Now federal regulators are 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.

Given the dire warnings from the Fed and other commentators regarding the precipice commercial lenders are at, one can speculate that the lenders will push the boundaries of prudence. How far must the value of collateral drop below the balance of the loan before it becomes high risk? That remains to be seen, but it may be that commercial borrowers are getting more breathing room then residential borrowers ever did.