

Bankers to Washington: Are we lending or not? (April 3, 2009)

Bankers confront regulators over mixed lending messages

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By Steve Cocheo, executive editor

More than 800 top banking officers gathered in Washington March 30-April 1 for ABA's Spring Government Relations Summit, to discuss critical banking issues and to bring their views on them to Capitol Hill. During the bankers' deliberations, they heard from many top federal officials, and they took ample advantage to ask often-pointed questions.

One of the hottest buttons on bankers' minds is the issue of lending, and the mixed messages that banks feel they are receiving about it from the feds. Government officials from the President down keep harping on the need for banks to get lending again, while field examiners seem hell-bent, in bankers' view, on getting banks to slam on the brakes. In addition, as raised by Diane Casey-Landry, ABA's chief operating officer, bankers have started to see the return of something not seen in the wake of examinations since the crisis of the 1990s: the "nonperforming performing loan."

Bankers asked both representatives of the Comptroller's Office and FDIC about the mixed messages coming from Washington on lending.

When this came up during her question-and-answer period, FDIC Chairman Sheila Bair noted that she is asked about this often.

"We want you to lend, but we want you to make prudent loans," she said. She added that, "some past underwriting standards were not what they should have been."

The FDIC has issued a great deal of written guidance to examiners on the matter, Bair said. "There's no secret about it." She suggested the agency could release the guidance to ABA for distribution to bankers. "It will empower you," she said.

Rather than express much sympathy for bankers who felt pulled both way, Bair actually took the side of her exam teams.

“Be understanding to our examiners,” added Bair. “They’ve got a tough job.” She expects commercial real estate loans to be more and more of an issue. “It’s going to be tough to work through,” said Bair.

The performing nonperformer explained

Comptroller John Dugan gave the first part of a technical two-part answer from his agency.

“Just because a borrower is current doesn’t mean the loan is performing,” said Dugan. “The issue is that as circumstances change, that will make it less likely the banks will be repaid, and if that is so, that has to be recognized, and that [recognition] comes in different shapes and sizes.”

Then Dugan turned the question over to his agency’s Chief National Bank Examiner, Deputy Comptroller Timothy Long, who gave a detailed answer that is worth reading in its entirety:

“The issue usually seems to surface when we’re talking about commercial real estate, particularly when we go into economic downturns. It was a big issue in the 1980s and 1990s.

“Probably 99% of the discussion revolved around commercial real estate loans. The reason is the way these things are structured. They are big, lumpy loans. It’s very difficult, when one of the loans gets into trouble, for a developer or guarantor to just step up and carry it, when it’s not working. The way commercial real estate [lending] is structured—whether it is acquisition and development loans, lot development loans, residential development loans, or condo loans in Miami—it’s normal practice to fund an interest reserve to bridge the timing of cash outflows and inflows on that loan while it’s being built and while it’s being leased, or the lots and the houses on them are being sold.

“When that loan quits working, it’s going to be current. We frequently run into, in some parts of the country, busted residential development projects; maybe they are supposed to take down four lots a month, and they haven’t taken one down in two quarters. And so, it’s clearly not working. It’s slowed down significantly.

“The interest is current. It may be because the bank is funding it themselves and they are paying themselves. Or maybe the borrower is actually paying them. In many cases the bank is paying themselves. So contractually, it is current. But in terms of performance, it’s not performing.

“Our examiners will come in and ask lots of questions about the project.

“There are dozens of different scenarios. You could run the gamut from the loan will be fine and they’ll pass it, even though the sales are not taking place, to the loan has a significant hole in it, it’s classified, there may be some doubtful, there may be some loss, there may be a nonperforming property. But if a loan is performing under reasonable terms, our examiners will not classify it and they won’t put it on nonaccrual.

“But, unfortunately, what we’re finding in some cases is that a development loan or a condo loan is not working. The interest carry is about to run out. The guarantor cannot carry the interest for an extended period of time or make periodic curtailments, particularly if the value of that loan has fallen. If you have a \$100 million condo project in Miami, you all know what the market is like there. If there’s a perceived \$20 or \$30 million hole in that project, it’s got to be filled. We don’t expect it to be filled today. But there’s got to be a plan by that borrower to carry the interest, to make some curtailments, to make some margin, and that’s where you get into the really difficult discussions.”

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