GSE Activity Report

Wednesday, July 5, 2023

Hoping for a Soft Landing

Summary

As an in-depth FedFin analysis today addresses (see FSM Report **REALESTATE25**), the banking agencies and NCUA late last week issued far-reaching guidance encouraging loan accommodations and even forbearance for troubled commercial real estate (CRE) projects, including multifamily obligations. In this report, we clarify implications for residential and multi-family loans, also providing second-order considerations for the GSEs.

Impact

Despite stout statements after the great financial crisis that the banking agencies would never again allow “extend-and-pretend” loan workouts, the new CRE policy may do just that not only for traditional CRE loans, but also for commercial-and-industrial (C&I) obligations backed by real estate and even other business assets. This policy thus gives banks and especially regional banks a wide comfort zone in which they are secure from examiner write-off and loss-recognition demands as long as the bank demonstrates effective internal credit-risk analytics and the borrower isn’t in acute distress.

Given that banks with the biggest CRE exposures are also facing the highest near-term capital hikes, this policy should ensure that solvent banks do not need to recognize losses that would force the supervisory sanctions associated with under-capitalization, but of course delayed work-outs can also ultimately prove expensive. Clearly, the Fed and the other agencies are hoping for the soft landing that makes this policy a win-win.

Nothing in this policy affects single-family loans. Although the CFPB has jurisdiction over mortgage servicing – and clearly plans to use it to protect borrowers – it only indirectly affects the way in which banks are required to forbear and/or recognize losses related to loan mods. These prudential and accounting considerations remain firmly under the banking agencies’ control and, for now, the rules are as they were.

This is not the case for multi-family obligations, where the banking agencies hold unlimited sway unless or until a loan is sold to the GSEs or into the CMBS market. In general, banks are actively encouraged to provide short-term accommodations for multi-family borrowers they believe have long-term repayment capacity. Lenders are also protected from having to write-down collateral if the borrower has reasonable repayment capacity and the bank can persuade skeptical examiners that local market conditions support the valuation.

The guidance also provides specific examples of what examiners will and should not demand if multi-family borrowers falter. In general, we read these as easing the pressure on banks to offload multi-family loans they think might evidence problems before actual performance makes them GSE ineligible,

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

reducing some of the cherry-picking already evident in this sector. To be sure, lenders could still roll over a problematic loan at newly-higher market rates without fear of examiner sanction, take the fees, and then sell it, renewing credit where credit might not otherwise flow based on the expectation of GSE or CMBS-issuer acquisition.

Outlook

The CRE guidance is immediately effective. The agencies note in passing that they are considering whether to issue like-kind guidance for other loan categories. Top on many banks' list will be residential loans given the near-term issues as rates rise in the IO-only jumbo sector. But, until there's guidance such as this, there will be write-offs such as those anticipated in recent bank failures and those that may be to come.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com