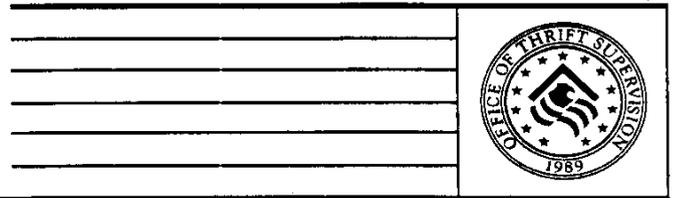


# ***Transmittal***



November 7, 1991

Number: 28

Attached are a news release and policy statement issued jointly by the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board that clarify the agencies' policies concerning the review and classification of commercial real estate loans. The purpose of the statement is to clarify existing guidance to ensure that supervisory personnel are

reviewing loans in a consistent, prudent fashion and that all interested parties are aware of the guidance.

Also attached are two OTS memoranda that highlight the major points included in the policy statement and outline the agency's policy on refinancing commercial real estate loans.

A handwritten signature in black ink, appearing to read "Timothy Ryan".

Director  
Office of Thrift Supervision

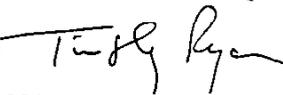
Attachments



Office of Thrift Supervision  
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

MEMORANDUM FOR CHIEF EXECUTIVE OFFICERS

FROM: Timothy Ryan 

DATE: November 7, 1991

SUBJECT: Interagency Policy Statement on the Review and  
Classification of Commercial Real Estate Loans

The recent decline in the availability of credit has been attributed to many factors, including the general slow down in the economy, the overbuilding of commercial real estate properties in some markets, and changed underwriting standards by lenders, as well as overly conservative supervisory actions. To ensure that regulatory policies and actions do not inadvertently curtail credit availability, the four Federal regulators of banks and thrifts have undertaken a number of actions to clarify and clearly communicate their policies. The attached policy statement is a further step in this effort.

On March 1, 1991, the four agencies — the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision (OTS) — issued a general policy statement that addressed a wide range of regulatory policies. Included in the March issuance were discussions of the workout of problem loans, lending by undercapitalized institutions, loan concentrations, enhanced disclosure of institutions' portfolios, and a general statement on the valuation of real estate loans. The attached policy statement expands upon the March 1 guidance as it relates to the review and classification of commercial real estate loans. While this policy statement is for the regulatory agencies' examination staff, it can also be used by lenders and appraisers to assist in their efforts to properly value real estate assets.

The intent of the statement is to clarify existing guidance to ensure that supervisory personnel are reviewing loans in a consistent, prudent fashion and to insure that all interested parties are aware of the guidance. The OTS expect supervisory personnel to use reasoned, balanced judgments in their evaluations of institutions' portfolios.

The policy statement emphasizes that the valuation of real estate loans is not based on liquidation values, but on a review of the borrower's willingness and capacity to repay and on the income-producing capacity of the properties over time. There have been allegations that supervisory personnel have used (or urged lenders to use) "liquidation" accounting, excessively high discount and capitalization rates, or other inappropriate supervisory analysis tools. While we believe that any such mistakes have been isolated instances, we believe it is useful to reiterate these basic principles that examiners, as well as lenders, follow in their evaluation of real estate loans.

The policy statement also clarifies how supervisory personnel analyze the value of collateral. In general, examiners rely upon the most recent appraisals of collateral to determine value and they review the major facts, assumptions and approaches used in the appraisals. Examiners seek to avoid challenges to underlying assumptions that differ in only a limited way from norms that would generally be associated with the property under review. Nonetheless, examiners are expected to review appraisals — and any management adjustments to them — to ensure they are not based on assumptions that are either overly optimistic or overly conservative. Our goal is for institutions to use appraisals that take a balanced view of the income-producing capacity of the properties over time.

The policy statement covers a wide range of specific issues, including:

- the process examiners use to review commercial real estate loan portfolios;
- the indicators of troubled real estate markets, projects, and related indebtedness;
- the factors examiners consider in their review of individual loans, including the use of appraisals, the determination of collateral value;
- a discussion of approaches to valuing real estate, especially in troubled markets;
- the classification guidelines followed by the agencies, including the treatment of guarantees; and,
- the factors considered in the evaluation of institutions' allowance for loan losses.

This statement is intended to ensure that all supervisory personnel, lending institutions and other interested parties have a clear understanding of our policies.

In addition to the guidance on the review and classification of commercial real estate loans, I have also attached an OTS memorandum issued in July on the refinancing of commercial real estate loans. This memorandum reiterates our policy to encourage savings associations to work with sound borrowers so that credit availability is not inappropriately reduced.

Please take the time to review these documents. I encourage you to share them with your Board of Directors. We expect all OTS supervisory staff to follow the policies outlined in these memoranda, although we recognize that these issues require the exercise of significant judgment on the part of examiners.

Attachments