Commercial Real Estate Concentrations Risk:

With Identified Problem Loan CRE and Troubled Debt Restructuring Portfolios

2009 National MDI Conference

Concentrations Risk Defined by FDIC

- 1) Concentrations of 25% or more of Tier 1 Capital by individual borrower, small interrelated group of individuals, single repayment source or individual project;
- 2) Concentrations of 100% or more of Tier 1 Capital by industry, product line, type of collateral, or short term obligations of one financial institution or affiliated group.
- 3) Any other concentrations may be listed in the 25% category if desired.
- NOTE: An appropriate percentage of total assets is used when a bank's capital is so low as to make its use meaningless. U.S. Treasury securities, obligations of U.S. Government agencies and corporations, and any assets collateralized by same are not scheduled.

Commercial Real Estate

Why are Regulators Concerned about CRE Concentrations?

- CRE lending is a significant business line
- Highly cyclical in most markets
- Concentration ratios are at record levels
- Risk management practices and strategic planning have not always kept pace with growth in CRE lending

3

CRE Concentrations Correlation to Ratings

As of March 31, 2009 Exam Information, # of Institutions	CRE ≥ 100%	CRE ≥ 500%
Composite 1	23	0
Composite 2	189	12
Composite 3	63	6
Composite 4	28	3
Composite 5	20	11
Avg. Composite	2.48	3.41

4

Supplemental Financial Institution Letter

- FDIC Releases to SNMs FIL-22-2008, Dated March 17, 2008
  - Managing CRE Concentrations in a Challenging Environment
- Re-emphasizes the importance of strong capital and loan loss allowance levels as well as robust credit risk management practices for highly CRE concentrated institutions
- Reminds banks to consult:
  - 2006 Interagency guidance on CRE Lending
  - 2006 Interagency guidance on ALLL
- Is consistent with Real Estate Lending Standards as prescribed by FDICIA of 1991 (authority 12 USC 1828(o), FDIC's 12 CFR Part 365).

5

Supplemental Financial Institution Letter (Cont.)

- Strongly encourages insured depository institutions to:
  - Increase or maintain strong capital levels
  - Ensure ALLL is appropriately strong
  - Manage C&D and CRE portfolios closely
  - Maintain updated financial and analytical information
  - Bolster the loan workout infrastructure
  - Continue making C&D and CRE credit available in your communities using prudent lending standards

6

Early Warning Signs of Deteriorating CRE portfolios

- **Inactive Board of Director Involvement**
- **No internal limits on CRE Lending**
- No internal tracking or stratification systems
- Limited DSC and cash flow assessment
- Weak Risk Identification Mechanism
- **Over-reliance on brokered deposits or other non-core sources to fund CRE Lending**
- Insufficient ALLL Methodology leading to untimely provision expenses
- Inadequate Capital to support the high risk profile of a highly concentrated CRE portfolio
- Lack of Comprehensive internal loan review with little or no independent testing
- **Actions taken only after past due is usually too late (over-reliance on delinquency report)**
- Negative Interest Reserves or IRs not managed according to contractual agreements. Includes extending additional funds to replenish IR
- Negative Escrow Accounts
- Slow to identify restructured debt as TDR in accordance with GAAP accounting

Troubled Debt Restructuring

- **A Troubled Debt Restructuring (TDR) is defined by FAS 15 as a restructuring in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.**
  - **TDR must continue to be reported as a TDR in the Call Report until the loan is paid in full (or otherwise disposed of, including through charge-off or foreclosure).**
  - **If the restructured loan is in compliance with its modified terms (as defined in the Call Report instructions) and the loan yields a market rate, the restructured loan need not continue to be reported as a TDR in the Call Report in calendar years after the year in which the restructuring took place.**

Commercial Real Estate Concentrations

Summary Points

- Risk management practices should be commensurate with risk profile of institution
- Capital adequacy will be evaluated on a case-by-case basis
- Guidance does not supersede the Agencies' real estate lending and appraisal standards

9

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QUESTIONS?

10