



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

**SR 09-07**

**October 30, 2009**

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK  
AND TO BANKING ORGANIZATIONS SUPERVISED BY THE FEDERAL RESERVE**

**SUBJECT: Prudent Commercial Real Estate Loan Workouts**

The Federal Reserve, along with the other financial regulators of the Federal Financial Institutions Examination Council (FFIEC),<sup>1</sup> has adopted the attached policy statement on *Prudent Commercial Real Estate Loan Workouts*. The Federal Reserve and the other financial regulators issued this policy statement to update longstanding guidance regarding the workout of CRE loans, especially in light of recent increases in such workouts. This guidance is intended to promote prudent CRE loan workouts at regulated financial institutions and to ensure examiners take a balanced and consistent approach in reviewing institutions' workout activities. If conducted in a reasonable and prudent manner, such workouts are often in the best interest of both the institution and the borrower.

Financial institutions that implement prudent loan workout arrangements after performing comprehensive reviews of borrowers' financial conditions will not be subject to criticism for engaging in these efforts, even if the restructured loans have weaknesses that result in adverse credit classifications. In addition, renewed or restructured loans to creditworthy borrowers on reasonable terms will not be subject to adverse classifications solely because the value of the underlying collateral declined.

The examiner's evaluation of a loan workout should be based upon the fundamentals of the particular loan, considering the project's current and stabilized cash flows, debt service capacity, guarantor support, and other factors relevant to the borrower's ability and willingness to repay the debt.

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<sup>1</sup> The other financial regulators are the Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and FFIEC State Liaison Committee.

## Overview of Guidance

The statement sets forth the appropriate standards for evaluating the management practices, workout arrangements, credit classification, regulatory reporting, and accounting for prudent CRE loan workouts, including:

- Risk management elements for the loan workout program
- Loan workout arrangements
  - Analyzing the repayment capacity of the borrower
  - Evaluating guarantees
  - Assessing collateral values
- Classification of loans
  - Loan performance assessment for classification purposes
  - Classification of renewals or restructuring of maturing loans
  - Classification of troubled CRE loans dependent on the sale of collateral for repayment
  - Classification and accrual treatment of restructured loans with a partial charge-off
- Regulatory reporting and accounting considerations
  - Implications for interest accrual
  - Restructured loans
  - Allowance for loan and lease losses

The statement includes examples of CRE loan workouts. The examples are provided for illustrative purposes only, and reflect examiners' analytical processes for credit classifications and assessments of institutions' accounting and reporting treatments for restructured loans. While the statement includes references and background materials related to regulatory reporting and accounting, appraisals and valuation concepts, and classification definitions, it does not change existing regulatory reporting or accounting guidance or standards. Rather, the guidance addresses supervisory expectations for reporting that reinforces longstanding guidance.

## Scope

This statement applies to loans that are secured by multifamily property, and nonfarm nonresidential property where the primary source of repayment is derived from rental income associated with the property (that is, loans for which 50 percent or more of the source of repayment comes from third-party, nonaffiliated, rental income) or the proceeds of the sale, refinancing, or permanent financing of the property. Further, the guidance covers loans for land development and construction loans (including 1- to 4-family residential and commercial construction loans), other land loans, loans to real estate investment trusts (REITs), and unsecured loans to developers. This is consistent with the definition for CRE loans in SR letter 07-1, "Interagency Guidance on Concentrations in Commercial Real Estate."

## Conclusion

Federal Reserve Banks are asked to distribute this letter to financial institutions supervised by the Federal Reserve in their districts, as well as to their own supervisory and examination staff. If you have any questions, please contact Jon Greenlee, Associate Director, Risk Management, at (202) 452-2962; Sabeth Siddique, Assistant Director, Credit Risk, at (202) 452-3861; Robert Walker, Senior Supervisory Financial Analyst, Credit Risk, at (202) 452-3429; Virginia Gibbs, Senior Supervisory Financial Analyst, Credit Risk, at (202) 452-2521; Lawrence Rufrano, Senior Supervisory Financial Analyst, Risk Policy and Guidance, at (202) 452-2808; and Linda Ditchkus, Senior Project Manager, Accounting Policy and Disclosure, at (202) 452-3506.

Patrick M. Parkinson  
Director

Attachment:

*Policy Statement on Prudent Commercial Real Estate Loan Workouts*

Cross References:

- SR letter 07-1, “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices”
- SR letter 06-17, “Interagency Policy Statement on the Allowance for Loan and Lease Losses”
- SR letter 05-14, “Interagency FAQs on Residential Tract Development Lending”
- SR letter 01-17, “Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions”
- SR letter 94-55, “Interagency Appraisal and Evaluation Guidelines”
- SR letter 93-30, “Interagency Policy Statements on Supervisory Initiatives Released Today”

Supersedes:

- SR letter 91-24, “Interagency Examination Guidance on Commercial Real Estate Loans”
- SR letter 91-25, “Interagency Examination Guidance on Commercial Real Estate Loans”