The Federal Reserve Board

Joint Press Release

Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

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Federal Banking Agencies Issue Final Guidance On Concentrations in Commercial Real Estate Lending

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation on Wednesday issued final guidance on sound risk management practices for concentrations in commercial real estate lending. The guidance is intended to help ensure that institutions pursuing a significant commercial real estate lending strategy remain healthy and profitable while continuing to serve the credit needs of their communities.

The agencies have observed that commercial real estate is an area in which some banks are becoming increasingly concentrated. This trend is particularly evident among small- to medium- sized banks that are facing strong competition in other business lines. The agencies support banks serving a vital role in their communities by supplying credit for business and real estate development. However, the agencies are concerned that rising commercial real estate loan concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in commercial real estate markets.

The final Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices reminds institutions that strong risk management practices and appropriate levels of capital are important elements of a sound lending program, particularly when an institution has a concentration in commercial real estate loans. The final guidance reinforces and enhances existing regulations and guidelines for safe and sound real estate lending. The guidance provides supervisory criteria, including numerical indicators to assist in identifying institutions with potentially significant CRE loan concentrations that may warrant greater supervisory scrutiny. These criteria do not constitute limits on CRE lending.

On January 10, 2006, the agencies issued proposed interagency guidance on concentrations in commercial real estate lending. The agencies have carefully considered these comments on the proposal and, as a result, have made changes to the proposal to clarify its purpose and respond to commenters' concerns. While the fundamental principles of the final guidance remain unchanged, the agencies have revised the guidance to:

- Emphasize that the guidance does not limit banks' commercial real estate lending, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations.

- Emphasize that the guidance is focused on commercial real estate loans that are dependent upon the cash flow from real estate held as collateral and sensitive to conditions in the commercial real estate market.
- Clarify that the guidance is not intended to apply to loans where commercial real estate collateral is taken as a secondary source of repayment or through an abundance of caution.
- Clarify that numerical screening criteria will be used as a supervisory monitoring tool to focus supervisory resources on institutions that may have significant commercial real estate loan concentration risk. A loan growth screen has been added to identify institutions with both high commercial real estate concentrations and recent rapid increases in these portfolios.
- Clarify that the strength of an institution's lending and risk management practices will be taken into account in supervisory evaluation of capital adequacy.

The agencies are committed to ensuring consistent application of this guidance and are developing training programs for their supervisory staff. These training materials will emphasize that the numerical screening criteria are not to be viewed as limits on an institution's commercial real estate lending activity.

The guidance is attached.

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