

[Real estate exposures aren't worrisome, banks say](#)

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Five out of 16 banks with midstate headquarters have concentrations of commercial real estate in their loan portfolios that exceed guidelines recommended by federal regulators.

However, regulators and industry analysts said the guidelines mean little in isolation, and higher numbers are not necessarily a sign of trouble.

“Not all commercial real estate is equal,” said Kevin Mukri, a spokesman for the [Office of the Comptroller of the Currency](#).

The banks at risk from their CRE — commercial real estate — portfolios are generally based in the South and West, where the nation’s speculative real estate boom of the mid-2000s was concentrated, said Michelle Lucci, a Tampa-based risk management specialist for [Banker’s Toolbox](#), a software developer for financial institutions.

“Your banks are in far, far better shape than what I have down here in Florida. Consider yourselves lucky,” she said.

Guidelines issued

Banks are considered to have CRE concentrations if they have construction and land loans on their books that exceed 100 percent of capital, or total CRE loans that exceed 300 percent of capital.

[Atlantic Central Bankers Bank](#) and [Mid Penn Bank](#) have CRE concentrations above 300 percent, and [Orrstown Bank](#) has construction and land loans that exceed 100 percent of capital, according to 2009 consolidated bank reports filed with the Federal Financial Institutions Examination Council. [Integrity Bank](#) and [PeoplesBank](#) exceed both guidelines.

In 2006, the [Treasury Department](#), the OCC and the [Federal Reserve](#) issued a directive advising banks to avoid CRE concentrations or face heightened regulatory scrutiny.

The agencies feared banks’ increasing reliance on real estate could create “safety and soundness concerns in the event of a serious economic downturn,” the directive said.

“We know that significant CRE concentrations in economic downturns can lead to an increase in problem banks, an increase in bank failures, loss of jobs, loss of incomes, loss to communities, loss to the deposit insurance fund and higher costs for all banks, even those that do not have CRE concentrations,” Comptroller of the Currency John Dugan

told a meeting of the [Independent Community Bankers of America](#) last month in Orlando.

Nevertheless, CRE concentrations remain high nationwide. More than one-third of U.S. banks had CRE concentrations as of the third quarter of 2009, including 47 percent of the 4,499 banks with assets of \$100 million to \$1 billion, according to the [Congressional Oversight Panel](#), citing data from [Foresight Analytics](#), an Oakland, Calif., a real estate market analysis company. Congress created the panel to review bank practices after the financial collapse that began in 2007.

The worst is yet to come on CRE loans, according to a February report from the panel. Commercial property values have fallen more than 40 percent since 2007, putting nearly half of borrowers underwater, and loan losses could cost banks \$200 billion to \$300 billion in the next few years, the panel said.

Banks with rising amounts of nonperforming loans must raise their allowances for loan losses to cover them. Given current trends, Pennsylvania community banks would need to add more than \$670 million to bring their loan loss coverage to 100 percent, according to the Federal Reserve Bank of Philadelphia.

In extreme cases, nonperforming loans trigger bank failures.

There were 41 bank failures in the first quarter of 2010, according to the Federal Reserve. One third of those were in Georgia and Florida, and the Northeast was relatively untouched. Only one of the 207 banks that have failed since 2008 was in Pennsylvania, according to the Fed.

Lower highs, higher lows

Local bank officials said Central Pennsylvania's relatively stable real estate climate and their own underwriting policies have kept their CRE risk manageable.

A given CRE concentration can be highly risky or not risky at all, depending on the quality of the underlying loans, said Jim Gibson, president of Integrity Bank. There's no way to determine which it is without going into specifics.

"Unfortunately, the reporting does not differentiate," he said.

Each type of CRE has its own risk profile, said Rory Ritrievi, president and CEO of Mid Penn Bank.

"You can't only focus on that 300 percent threshold," he said.

Loans for owner-occupied properties such as professional offices are typically considered highly safe, he said, while those for land development and "spec" housing — units built in hopes of finding buyers — are generally riskier.

Construction loans account for 18 percent of CRE loans at Pennsylvania community banks, but 62 percent of their nonperforming CRE loans, according to the Federal Reserve Bank of Philadelphia.

Zero defaults

Yet even loans to spec developers can be safe if done right, Gibson said. Houses less than \$250,000 are selling in the midstate, even in the recession, and Integrity's construction loans are doing fine, he said.

"I have zero loans that are in any type of default at that price point," he said.

Mid Penn overhauled its lending practices in 2009 and managers thoroughly reviewed its loan portfolio,

"really being honest in the way we rated the loans," Ritrievi said. He said the bank's loan allocations across the various CRE sub-sectors are well balanced and he is comfortable with them. The bank does not have land development loans, he said.

Integrity does careful industry and individual loan analysis, Gibson said. It also conducts "stress tests" to make sure borrowers will be able to repay if interest rates rise, which is likely given their low level, he said.

As long as a bank can demonstrate to regulators that it is managing its risk appropriately, a CRE concentration is not a cause for undue concern, Ritrievi and Gibson said.

That's true, the OCC's Mukri said.

"Some banks have a long history (of showing) they manage concentrations very well," he said.

Comptroller Dugan said federal regulators plan to issue stricter standards on CRE. However, they have not yet done so.

Ritrievi said community banks can't simply withdraw from CRE lending — it's their "bread and butter."

Larger banks can diversify into insurance, investment and other products in ways that community banks can't, and also can be more aggressive with their commercial and industrial lending, he said.

"This is where the business has been for community banks and always will be," he said.

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Commercial real estate (CRE) concentrations among midstate banks

Federal regulators recommend banks keep construction and land loan exposure below 100 percent and risk-based capital or CRE exposure below 300 percent. Those that don't may face heightened risk and regulatory scrutiny.

Atlantic Central Bankers Bank	92 percent	316 percent
Integrity Bank	165 percent	502 percent
Mid Penn Bank	75 percent	557 percent
Orrstown Bank	121 percent	274 percent
PeoplesBank	114 percent	358 percent