**Policy 7315: Commercial Real Estate Loan Workouts and Modifications**

**Model Policy Revised Date: 10/03/2024**

**General Policy Statement:**

While commercial real estate (CRE) borrowers may experience deterioration in their financial condition, many continue to be creditworthy members who have the willingness and capacity to repay their debts. [[CUname]] (Credit Union) will work constructively with its CRE borrowers who are financially unable to make their contractual payment obligations on their loans, consistent with safe and sound lending practices. This policy outlines the factors that the Credit Union will take into consideration when deciding whether to enter into a loan workout with its CRE borrowers.

1. **RISK MANAGEMENT PRACTICES**. The Credit Union will employ the following risk management practices with respect to loan workout arrangements for its CRE borrowers:
   1. Sufficiently identify, control and manage the volume of and complexity of workout activity. All loans under a workout arrangement, along with the status of each, will be reported to the Board [[7315-1]].
   2. Maintain documentation in the loan file regarding the borrower’s financial condition that justifies a loan workout arrangement, as well as the value of the collateral involved.
   3. Ensure that its information systems and internal controls adequately identify and track loan performance and risk, including concentration risk.
   4. Report all commercial real estate loan workouts pursuant to the requirements of Generally Accepted Accounting Principles (GAAP). Management will ensure that loan workout staff appropriately communicates with the accounting and regulatory reporting staff concerning the Credit Union’s loan restructurings, and that the reporting consequences of restructurings are presented accurately in regulatory reports.
   5. Follow its Collection Process policy **(See Policy 7510)** in the event the CRE borrower cannot repay a loan under a workout arrangement.
   6. Adhere to all statutory and regulatory requirements, as well as its internal lending limits for CRE loans.
   7. Properly administer its collateral by ensuring the proper lien perfection of the Credit Union’s collateral interests for both real and personal property.
   8. Review the credit of its borrowers on a regular basis.
   9. Monitor the ongoing performance of the borrower and guarantor under the terms of a workout.
   10. Implement and maintain an internal loan grading or internal risk rating system that accurately and consistently reflects the risk in the workout arrangements executed.
   11. Employ an Allowance for Credit Losses methodology in accordance with GAAP, for loans that have undergone a workout arrangement and recognizes loan losses in a timely manner through provision expense and recording appropriate charge offs.
2. **ELIGIBILITY REQUIREMENTS**. Before granting a loan extension, the Credit Union will take the following factors into consideration:
   1. **Borrowers.**
      1. The ability to repay a loan under a workout arrangement; including a review of current credit reports and income verification.
      2. Whether the inability to repay the loan under the current terms is temporary or long-term.
      3. Whether there is a guarantor.
   2. **The Condition of the Loan.**
      1. The amount delinquency.
      2. The length of time the loan is past due.
      3. Whether the loan documents are in order (i.e., signed, recorded and contain all of the correct information).
   3. **The Condition of the Property.**
      1. Determine current property value.
      2. Obtain an updated title search to confirm the Credit Union's lien position and verify that no one other than the member has title to the property.
      3. Whether there is property damage that would significantly affect its value (i.e., damage due to fire, flood, wind, or other natural disaster; environmental contamination, etc.).
      4. Whether there has been a significant change in the area surrounding the property that would affect its value (i.e., zoning changes, or physical or environmental damage to surrounding area).
      5. A material deterioration in the factors outlined in Section 4(C)(ii) herein.
   4. **Limits.**
      1. The Credit Union will set the following limits on commercial real estate loan workout arrangements:
         1. **Open-End Loans.** In general, open-end loans will not be re-aged more than once within one 12-month period, and no more than twice within any 5-year period. However, the Credit Union may re-age (re-age meaning returning a delinquent, open-end account to current status without collecting the total amount of principal, interest, and fees that are contractually due) an account after it enters a workout program, but only after receipt of at least 3 consecutive minimum monthly payments or the equivalent cumulative amount. The Credit Union will not authorize additional advances to fund unpaid interest and Credit Union fees.
         2. **Closed-End Loans.** Closed-end loans will not be extended (extending monthly payments and rolling back the maturity by the number of months extended), deferred (deferring a contractually due payment without affecting the other terms, including maturity of the loan), renewed (underwriting a matured loan generally at its outstanding principal amount and on similar terms), or rewritten (underwriting an existing loan by significantly changing its terms, including payment amounts, interest rates, amortization schedules, or its final maturity) more than [[7315-2]].
         3. **Aggregate Limit.** The Credit Union will also not exceed [[7315-3]]% of net worth in loans within workout.
3. **SHORT-TERM LOAN ACCOMODATION**. The Credit Union will work proactively and prudently with borrowers who may be unable to meet their contractual payment obligations during periods of financial stress. These will be generally short-term or temporary in nature and occur before a loan reaches a workout scenario. The Credit Union will comply with risk management practices, analysis/maintenance of information and classification as outlined with policy. Disclosure about the arrangement of the accommodation to the borrower and any guarantor will be clear, accurate and timely.
4. **TYPES OF WORKOUT ARRANGEMENTS**. The type of workout arrangement will be determined by the type of commercial loan granted. Loan workouts will not be extended or authorized and no additional advances on open-end loans will be allowed to finance unpaid interest or credit union fees. Third party fees, such as forced-place insurance or property taxes, can be financed or advanced through a loan workout. The following will be considered when entering into a workout arrangement:
   1. **Refinancing**. The Credit Union may choose to refinance a loan if the CRE borrower has sufficient cash flow, equity, the ability to complete a project or rent remaining space, and/or the ability to pay a more affordable loan.
   2. **Loan Modifications**. When a borrower has little or no equity and the inability to pay the current loan payment, but desires to continue construction or fill available rental space, the Credit Union may choose to modify the loan. The following types of loan modifications may be considered:
      1. Renewing or extending the term of the loan in order to reduce the monthly payment amount.
      2. Restructuring the loan with or without concessions;
      3. Reducing the interest rate to lower the monthly payment amount;
      4. Changing from an adjustable rate to a fixed rate interest loan to eliminate payment shock;
      5. Rolling over past-due amounts and re-amortizing the new amount due;
      6. Forgiving past due amounts;
      7. Forgiving past due amounts and requiring a share of the equity in a future sale;
      8. Obtaining a second lien on further assets;
      9. Granting additional credit to improve prospects for overall repayment; or
      10. Any other type of prudent, creative solution that does not violate safety and soundness.
5. **REPAYMENT ABILITY, ANALYSIS, AND MAINTENANCE OF INFORMATION**. The Credit Union will conduct a detailed analysis of the borrower’s ability to repay the loan. This analysis will ensure the borrower has the willingness and ability to repay the loan under reasonable terms and cash flow potential of the underlying collateral or asset. When analyzing the repayment ability, the Credit Union will maintain and document some or all of the following information:
   1. **Updated and Comprehensive Financial Information on the Borrower and Real Estate Project**. When analyzing a commercial borrower’s repayment ability, the Credit Union will analyze the following:
      1. A realistic projection of the borrower’s expenses.
      2. The character, overall financial condition, resources, and payment history of the borrower.
      3. The nature and degree of protection provided by the cash flow from business operations, as well as availability, continuity and accessibility of repayment sources or the collateral on a global debt service coverage basis that considers the borrower’s total debt obligations.
      4. Market conditions (federal, state, and local level) that may influence repayment prospects and the cash flow potential of the business operations or underlying collateral.
      5. The prospects for repayment support and available cash flow from any financially responsible guarantors.
   2. **Updated and Comprehensive Financial Information on the Guarantor**. The Credit Union will analyze the following attributes of a financially responsible guarantor:
      1. A realistic projection of the guarantor’s expenses, including financial condition, income, liquidity, cash flow, contingent liabilities and other relevant factors (including credit ratings, when available) to demonstrate the guarantor’s financial capacity to fulfill the obligation.
         1. This assessment will include the consideration of the total number and amount of guarantees currently extended by a guarantor in order to assess whether the guarantor has the financial capacity to fulfill the contingent claims that exist. A similar analysis will be done for any other material sponsors that support the loan.
      2. The financial capacity and willingness to provide support for the credit through ongoing payments, curtailments or re-margining.
         1. This assessment will include whether past performance under guarantees was voluntary or the result of legal or other actions by the Credit Union to enforce the guarantee.
      3. The adequacy of the guarantor to provide support for repayment of the indebtedness, in whole or in part, during the remaining loan term.
      4. The legality and enforceability of the guarantee.
   3. **Current Valuations of the Collateral Supporting the Loan and Workout Plan**. This analysis ensures that the Credit Union’s assumptions and conclusions are reasonable.
      1. Collateral valuations will be updated as part of the ongoing credit review, as market conditions change, or a borrower’s financial condition deteriorates.
      2. For CRE loans involved in a workout situation, a new or updated appraisal or evaluation, as appropriate, will address current project plans and market conditions are considered in the workout plan. The consideration will include whether there has been material deterioration in the following factors:
         1. The performance of the project.
         2. Conditions for the geographic market and property type.
         3. Variances between actual conditions and original appraisal assumptions.
         4. Changes in project specifications (i.e., changing a planned condominium project to an apartment building).
         5. Loss of a significant lease or a take-out commitment.
         6. Increases in pre-sales fallout.
      3. Estimate the cost to the credit union, as measured by a NPV test, of any approved modification to verify it is less than the estimated cost of foreclosure or other foreclosure prevention alternative (e.g., short sale, deed in lieu of foreclosure, cash for keys, etc.), unless extenuating circumstances exist, and document the NPV analysis in the loan file.
      4. The Credit Union will ensure that the documentation on the collateral’s market value will demonstrate a full understanding of the property’s current “as is” condition (considering the property’s highest and best use) and other relevant risk factors affecting value.
         1. However, depending on the type of loan workout and loan commitment, the Credit Union may also consider an “as complete” market value, or an “as stabilized” market value.
         2. The Credit Union will use the fair value (less costs to sell) of the property in its current “as is” condition, in the event the Credit Union decides to foreclose.
      5. The Credit Union will consider expected cash flow from the property, current or implied value, and relevant market conditions. For income-producing property, the Credit Union will evaluate:
         1. Net operating income of the property as compared with budget projections, reflecting reasonable operating and maintenance costs;
         2. Current and projected vacancy and absorption rates;
         3. Lease renewal trends and anticipated rents;
         4. Effective rental rates or sales prices, considering sales and financing concessions;
         5. Time frame for achieving stabilized occupancy or sellout;
         6. Volume trends in past due leases; and
         7. Discount rates and direct capitalization rates.
   4. **Documentation on the Value of Additional CRE Borrower Assets**. Many CRE borrowers may have other indebtedness secured by other business assets, such as furniture, fixtures, equipment, inventory, and accounts receivable. The Credit Union will quantify the value of such assets, determine the acceptability of the collateral, and perfect its security interests. The Credit Union will monitor the value of its collateral interests and security protection.
   5. **Documentation on the Appropriate Loan Structure** (i.e., term and amortization schedule), curtailment, covenants, or re-margining requirements.
   6. **Appropriate Legal Analyses and Documentation for any Loan Term Changes**.
6. **CLASSIFICATION OF LOANS**. The Credit Union will “classify,” or assign a grade and place on a “watch list,” all CRE loans that demonstrate well-defined weaknesses that jeopardize the orderly repayment of the loan in accordance with reasonably modified terms. A loan’s record of performance will be considered when determining whether a loan should be classified.
   1. The Credit Union will also comply with the general loan workout, modification and nonaccrual standards policy and corresponding accounting treatment.
   2. For well-defined weaknesses that jeopardize collection in full amounts contractually due, the result may be a partial charge-off as part of a restructuring. The remaining recorded balance will be classified accordingly.
7. **EXCEPTIONS.** Any exceptions to policy will be presented to the Board for approval and may require additional reporting.