CRE Tech can radically reduce the cost of regulatory compliance while improving risk controls, deal selection and profitability

Regulators around the world are demanding lenders comply with stricter guidelines for measuring risk and potential losses in commercial real estate debt. The FASB has modified its CECL standards to include requirements to measure the lifetime expected loss for individual loans and portfolios. The FASB new CECL standards become effective in 2020 whilst the IASB's IFRS 9 will be adopted in 2018. Many lenders have yet to implement solutions meeting the necessary requirements.

Meeting CECL/IFRS 9 requirements for Commercial Real Estate Lenders

ProMS is the only robust and tested solution to meet CECL and IFRS 9 requirements 'out of the box' which works in all OECD economies. Lenders can implement and start using validated underwriting, pricing and portfolio tools in four to six weeks from project start. In this time ProMS enables a mid-size lender to load and analyse its back-book, train staff and implement new underwriting and portfolio management processes. ProMS' advanced tools enable rapid data integration via APIs, ETLs or other protocols to industry standard software such as Closer, Rockport, Argus and SAP. ProMS' modular architecture is so adaptable that it has been implemented at the world's largest lenders, covering multicurrency portfolios of up to $100b, as well as at more modest institutions with limited resources such as community and mutual banks.

ProMS is a ready to run cloud delivered solution requiring no customisation and preconfigured with all CRE loan products: Office, Multifamily, Industrial, Malls, Semi-Stabilized and Construction etc. and all MSAs in the US market and EU/GB property sectors. Using the best available market data and advanced analytics ProMS calculates underwriting and risk metrics at the loan and portfolio level (LTV and DSCR Coverage Ratios, PD, EAD, LGD, EL, MPL, RAROC and EP) to meet and exceed the relevant regulatory rules and reporting standards.

The FASB has provided a timeline for the implementation of CECL for US CRE lenders of January 1, 2020. The regulations coming into force will require a lender to implement an expected credit loss model, that utilises historical information, current conditions and reasonable forecasts to estimate the *expected loss over the life of the loan*.

The requirements additionally include[1]*:*

- *Governance and risk management framework*
- *Development of robust, well-documented data quality processes that provide details for extract, transform, and load (ETL) procedures as well as data quality scorecards or reports*
- *Separation of loan-level characteristics to be used in modeling probability of default (PD) and loss given default (LGD) parameters, to align ALLL practices with Basel requirements*
- *Portfolio segmentation with sufficient granularity to appropriately forecast expected credit losses*
- *Credit risk modeling and forecast models and methodologies*

[1] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (the agencies) are jointly issuing this statement to remind financial institutions of existing regulatory guidance on prudent risk management practices for commercial real estate (CRE) lending activity through economic cycles

- *Quantitative tools aligned and calibrated for use across the capital management framework to ensure consistency*
- *End-to-end process redesign and control environment*

ProMS is the only ready to deploy solution that meets these regulatory requirements. Additionally, ProMS enables lenders to comply with the following:

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

Lenders must demonstrate:

- *strategies to ensure capital adequacy and allowance for loan losses that supported an institution's lending strategy and were consistent with the level and nature of inherent risk in the CRE portfolio.*
- *conducted global cash flow analyses based on reasonable (not speculative) rental rates, sales projections, and operating expenses to ensure the borrower had sufficient repayment capacity to service all loan obligations.*
- *performed market and scenario analyses of their CRE loan portfolio to quantify the potential impact of changing economic conditions on asset quality, earnings, and capital.*
- *provided their boards and management with information to assess whether the lending strategy and policies continued to be appropriate in light of changes in market conditions.*
- *assessed the ongoing ability of the borrower and the project to service all debt as loans converted from interest-only to amortizing payments or during periods of rising interest rates.*
- *implemented procedures to monitor the potential volatility in the supply and demand for lots, retail and office space, and multi-family units during business cycles.*
- *maintained management information systems that provided the board and management with sufficient information to identify, measure, monitor, and manage concentration risk.*
- *implemented processes for reviewing appraisal reports for sufficient information to support an appropriate market value conclusion based on reasonable market rental rates, absorption periods, and expenses*

Market conditions[2].

The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:

- *Current and projected vacancy, construction, and absorption rates.*

[2] FDIC Law, Regulations, Related Acts,2000 - Rules and Regulations, PART 365—REAL ESTATE LENDING STANDARDS, Subpart A—Real Estate Lending Standards, Appendix A to Subpart A of Part 365—Interagency Guidelines for Real Estate Lending Policies

- *Current and projected lease terms, rental rates, and sales prices, including concessions.*
- *Current and projected operating expenses for different types of projects.*
- *Economic indicators, including trends and diversification of the lending area.*
- *Valuation trends, including discount and direct capitalization rates.*

Please contact us to learn how data and advanced cloud computing can enable your firm to rapidly and cost effectively meet the burden of risk regulation.

Radley Associates is an independent firm dedicated to the development of advanced simulation based analytics for the Commercial Real Estate industry. Our clients include leading banks, fund managers and REITS. We have deep expertise in property, simulation modelling, econometric analysis and risk.

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