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Community Banks and CRE Loans: Lending Challenges

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Over the last few years much has been written about the role several of our nation's largest banks, money centers, mortgage companies, etc. played in the subprime debacle and near financial collapse of our banking system. Conversely there has been very little written about the fact that community banks played little if any role in creating these problems.

Despite this fact, community banks have been impacted more than any segment in the banking industry, as evidenced by their large number of failures. Community banks' greatest portfolio losses are centered in commercial real estate lending, particularly in spec (properties for sale or lease) construction, raw land (unimproved property held for development) and non-owner occupied investment properties.

In their analysis of failed or problematic banks, the regulatory agencies recognized that the issue of concentrations, most notably in real estate portfolios, were reoccurring from previous recessions and, as such, were cause for action.

As a result, the regulatory agencies that oversee the banking industry, and who are being held accountable for its stability, see the management of portfolio concentrations just as critical as the return to traditional, more conservative loan underwriting standards.

This has caused community bank executives to shift their lending strategies away from real estate related loan products and toward business lending. This change in strategy is driven in good part because of regulatory requirements addressing portfolio concentrations, which require most banks to substantially shrink their real estate portfolios before they can lend against real estate again.

In an environment that includes declining real estate values, more conservative underwriting and a mandate for banks to lower their real estate loan concentrations, it's no surprise that consumers feel that real estate financing is unavailable. On the positive side, as banks work through these portfolio issues, they will become active in the real estate lending market again, but with a more focused eye on managing concentrations and related risks.