Stress Testing for the Commercial Real Estate Portfolio

Federal Reserve Symposium
September 13 and 14, 2012
Main Messages

Two main messages

› Your own data is best – supplementing with external data only as necessary

› Build for post CCAR life - must become integrated into everyday decisions
Model Architecture

Two basic approaches

› Bottom-up or
› Top-down

Both have strengths and weaknesses and require assumptions

Resist thinking of either one as better - depends on the ultimate purpose of the model
The Great Constraint

DATA

CMBS and CRE portfolios share similar characteristics
› Property type
› Sensitive to same drivers

Using CMBS data is extremely attractive, but key differences must be recognized
Key Similarities

› Real Estate Assets

› Extremely dependent on local market conditions

› Bank lending connected to CMBS lending
Key Differences

› Definition of Default

› Property Differences

› Resolution Strategy

› Impact of Credit Culture

› Different Loan Classes
Unique Issues

› Balloon loans:
   › Take-out agreements
   › Lack of CMBS market
   › Individual bank’s underwriting appetite

› Guarantees
   › Capacity and willingness
   › Impact PD or LGD

› Changes in Problem Asset Management strategy
Concluding Remarks

› Leverage your internal data

› Integrate loss forecasting to all activities
   › Servicing, Risk rating, Allowance setting, strategic planning, etc.

› Share to Improve

“IN THE LONG RUN, NOTHING IS MORE DESTRUCTIVE TO VALUE THAN A STUPID COMPETITOR”