PRESS RELEASE
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FDIC REPORT PROVIDES EARLY WARNING OF POTENTIAL PROBLEMS IN CONSTRUCTION AND COMMERCIAL REAL ESTATE LENDING

FOR IMMEDIATE RELEASE

The latest FDIC report on banks' underwriting standards showed no widespread problems currently, but indicated that lending for both commercial real estate and construction should be monitored carefully in the future. Compared to the previous report issued last May, more institutions active in commercial real estate and construction lending made higher-risk loans of these types. For example, of the banks examined that were actively making construction loans, almost 25 percent frequently funded speculative construction projects, compared to 18 percent in the previous report.

"Loan growth and increased competition are the typical reasons that banks relax their underwriting standards," said FDIC Chairman Andrew C. Hove, Jr. "Currently there's no cause for alarm, but our results show that certain underwriting practices, especially involving construction and commercial real estate loans, should continue to be monitored carefully."

For the latest period, FDIC examiners reported on lending practices at 1,233 FDIC-supervised institutions examined by the agency during the six months ending September 30, 1997. The examiners provide a general assessment of each institution's underwriting standards and comment on specific types of loans. Examiners classify the occurrence of specific risky practices as "frequent enough to warrant notice" or, if more prevalent, as "commonly or as standard procedure." Most of the banks examined were small, community-based institutions. They represented 20 percent of the number of institutions supervised by the FDIC. They held 25 percent of the assets of FDIC-supervised banks.

Of the 398 banks examined that were actively making construction loans, almost 25 percent frequently funded speculative construction projects -- lending to developers who have no commitments for the sale or lease of the property. That proportion is higher than the 18 percent in the previous report. About four percent did such speculative lending commonly in both periods. Also, almost 17 percent of these lenders frequently made construction loans where the only repayment source was the potential income from the property after its completion; no additional repayment sources were considered if the project were to fail. An additional three percent followed this questionable practice commonly. These, too, are higher proportions than the earlier 11 percent and one percent, respectively.

At the 659 banks examined that were actively making commercial real estate loans, approximately 11 percent (up from eight percent previously) failed to consider alternative repayment sources, other than the project being funded, on a basis frequent enough to warrant notice. Less than two percent (compared to none previously) followed this practice commonly or as standard procedure.

On the situation generally, slightly more than nine out of 10 institutions examined during the period showed no material change in overall underwriting practices since their last examination. Close to six percent tightened their underwriting standards, but four percent loosened them. These results are in line with previous FDIC reports dating back to early 1996. Also among other findings:

- Almost 10 percent of the banks examined had above-average risk in underwriting practices for new loans, down from 12 percent in the previous report (October 1996-March 1997).

- Roughly 13 percent of the banks examined showed above-average risk in loan administration, versus 15 percent previously.

Approximately 13 percent frequently had high concentrations of new loans to one borrower or industry (compared to nine percent previously). An additional seven percent commonly had high concentrations of loans to one borrower or industry (up from five percent previously).

The report on loan underwriting practices of banks, obtained through an examiner reporting system implemented in early 1995, is one of a number of FDIC initiatives aimed at providing early warnings of potential problems in the banking system. In addition, the information gathered during examinations helps the FDIC target future examiner resources and identify potential weaknesses in underwriting practices that will draw additional attention during on-site examinations.

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