



Under Basel III, lenders will closely monitor borrowers

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By Matt Hudgins

Commercial real estate borrowers should prepare to provide ongoing cash flow information to the lenders who finance their properties. For that they can thank the Basel III accord, which is part of the rule changes being drafted by federal regulators.

Lenders will need that vital information from borrowers on a regular basis throughout the loan term to assess risk, says **Chris Marrison**, CEO of **Risk Integrated LLC**, a consultant based in Cold Spring, N.Y. Lenders will need to set aside additional capital reserves when the risk of default increases.

“Commercial real estate investors should expect that they will need to give more information, more regularly, to the people giving them debt,” says Marrison.

The international Basel Committee on Banking Supervision, of which the U.S. Federal Reserve is a member, drafted a set of guidelines in 2010 to increase capital stability around the globe.

The Basel III accord — named for Basel, Switzerland, where the committee meets — spells out how much equity a lender must maintain to offset potential losses based on the risk level in its portfolio. The accord also provides guidelines on how lenders can assess that risk.

As Basel III becomes part of lending practices in the United States, lenders will

need to monitor their risk in order to determine how much capital they must keep in reserve, says Marrison.

Risky loans will increase reserve requirements, but so will inadequate information about property cash flows. “Lenders will be pressured to set aside more capital if they can't prove they understand their risk,” he says. “Lack of knowledge is uncertainty, and uncertainty is risk, and risk entails more capital.”

Basel III also calls for lenders to mitigate some cyclical risks by matching debt structures to the collateral. For example, a fixed-rate mortgage might be a good match for an office building with a 20-year lease to a single tenant.

By contrast, a retail property with frequent lease rollovers and performance-based rent might be better matched to a floating-rate mortgage that adjusts the owners' debt payments as the economy expands or contracts.

Mismatched loans increase a lender's risk, Marrison explains. Under Basel III, the increased risk translates into greater capital reserve requirements and higher borrowing costs. “It's not just about the market,” he says. “It's about how the property and the loan match.”