Commercial Real Estate Risk Assessment

While most attention has focused on the troubled housing industry and its role in precipitating the current financial crisis, commercial real estate is now showing troubling signs of a downturn. Investment in commercial structures has slowed after several years of rapid growth, leaving lending institutions with large CRE loan exposures and inadequate practices to effectively manage their risks.

Developing effective and appropriate internal risk rating frameworks to optimize risk and return means tackling a number of common internal and external complexities.

Institutions that do not have a consistent, standardized, and validated approach for the analysis of their commercial real estate exposures will be challenged both in growing earnings via loan origination or investment and in monitoring and adapting to the changing credit risks within their portfolios.

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<th>External Factors</th>
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<tr>
<td>Varying real estate property types, including office, multi-family, retail, industrial, mixed-use, and related infrastructure</td>
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<td>Changes in credit risks associated with different phases of a property's life cycle, such as construction, lease-up, or stabilized</td>
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<td>Multiple components of risk associated with construction companies, developers, investors, properties, and projects</td>
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<td>Cyclical property market forces that impact rents and vacancy, capitalization, and interest rates</td>
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<table>
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<th>Internal Factors</th>
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<td>Non-standardized tools such as spreadsheets used to capture and analyze information</td>
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<td>Application of subjective risk rating processes that typically are not validated through a market downturn</td>
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<td>Inadequate market and internal information and processes to consistently capture, analyze, and forecast changes in credit exposures</td>
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<td>Lack of integration of various components of real estate market, capital market, property, borrower, tenant, and investor characteristics to create a synthesized view of risk</td>
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Our Approach

Moody's Analytics Consulting Services can work with you to develop, validate, calibrate, document, and stress test your CRE credit risk rating systems and policies to enable more effective risk management. Our professionals can also work with you to evaluate existing assets and develop portfolio management and optimization strategies. Our approach leverages decades of experience in credit risk assessment, our experts' knowledge of industry best practices, leading-edge methodologies, and one of the industry's largest proprietary data sets on defaults. We take the time to understand the unique aspects of your business and develop a solution that helps you achieve your financial and risk objectives.
Our experts address the risks associated with all real estate sectors, including construction, land and property development, renovation and re-purposing, and income-producing residential and commercial real estate. We leverage Moody’s market-leading housing and economic forecast data in combination with counterparty and project information, producing statistically validated PD and LGD – key components of a regulatory-compliant dual risk rating system. Our consultants work with you to understand how your institution is organized around activities and develop a layer to integrate the various components of risk and arrive at a more holistic view of your exposures.

**Developer**
Project modeling based on market conditions and the marketing power and track records of the participants to assess the risk of the project. Factors can include:
- Real estate market conditions
- Construction risk (cost overruns, delays)
- Take-out financing/valuation requirement
- Pre-sale figures

**Construction Company**
Corporate modeling with industry adjustments to estimate the probability of repayment from company revenue. Factors can include:
- Financial position
- Company track record
- Management quality

**Property**
Cash flow modeling that incorporates market and project factors to estimate the probability of repayment from property income. Factors can include:
- Loan term and structure, location, property quality
- Real estate forecasts (supply, vacancy, rents)
- Capital market forecasts (inflation, interest rates)

**Integration Layer**
Connects the developer, investor, and builder components to assess overall credit risk.

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**Our Commitment**

**Unparalleled Expertise and Thought Leadership**
Professionals with practical experience as former analysts, practitioners, and regulators – backed by over 30 years of credit risk data and a century of experience in risk assessment – provide independent evaluations and insights that reflect a true understanding of your business, wherever you are in the world

**Proven Methodologies and Data**
Leading edge tools, robust and validated models, transparent frameworks, and the industry’s most comprehensive proprietary credit risk data set drive immediate results

**Comprehensive Solutions**
A multidisciplinary and integrated view of risk management across the value chain creates solutions customized to your needs, from data architecture through advanced portfolio optimization, to support more effective decision-making

**Contact Us**
To learn more about how Moody’s Analytics Consulting Services can help you meet your credit risk challenge, please contact one of our specialists or email consulting@moodys.com.

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