The Fed - Loan Modifications and the Commercial Real Estate Market

Author:David Glancy, Robert J. Kurtzman, and Lara Loewenstein

Date:2022-08-01

Keyword:NA

Url:[click here](https://www.federalreserve.gov/econres/feds/loan-modifications-and-the-commercial-real-estate-market.htm)

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From:FEDS-working\_paper

August 2022  
  
   
  
   
Loan Modifications and the Commercial Real Estate Market  
David Glancy, Robert J. Kurtzman, and Lara Loewenstein  
Abstract: Banks modify more CRE loans than CMBS, contributing to better loan performance when property incomes decline. However, banks have higher delinquency rates for less-stressed loans, consistent with modification policies encouraging strategic default. Motivated by these facts, we develop a tradeoff theory model in which lenders vary in their modification technologies. Modification frictions discourage strategic renegotiation, enabling CMBS to offer higher LTV loans and attract borrowers seeking higher leverage. The model produces cross-lender differences in LTVs and spreads consistent with the data. Reducing modification frictions at CMBS decreases welfare by restricting debt capacity for the borrowers that value it most.  
Keywords: commercial real estate, modifications, LTV  
DOI: https://doi.org/10.17016/FEDS.2022.050  
  
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