



TOPICS:

Credit risk

SOURCE:

European Central Bank

ECB: On-site Insights - Good Practices for CRE Bullet Loan Lenders

- The ECB outlines **key risk management practices for commercial real estate (CRE) bullet loans** - also known as interest-only loans - which have come under scrutiny amid rising interest rates and structural shifts in real estate markets. Bullet loans, common in CRE development and income-producing real estate, pose heightened refinancing risk due to the absence of principal amortisation until maturity.
- The report emphasizes that managing refinancing risk begins with **clear definitions** and **measurable metrics**. Leading banks anchor their assessments in lending policies that account for market norms, tenant demand, energy efficiency upgrades and the economic life of assets. Effective practices include integrating forward-looking cash flow projections, stress-testing key indicators such as loan-to-value (LTV) ratios and debt service coverage and using heatmaps to monitor portfolio-level risks.
- To ensure risk models are robust, lenders are advised **to factor in refinancing risk** throughout the loan lifecycle and adjust for new macroeconomic conditions, particularly the shift from a low to a high interest rate environment.

- A detailed case study illustrates how deteriorating collateral values and rising interest costs can push LTV and interest coverage ratios beyond internal limits, requiring significant equity injections for loan restructuring.
- Accurate and timely **collateral valuation** is deemed critical. Leading institutions accelerate revaluation cycles in response to market changes, perform full revaluations at least triennially, and apply independent valuation reviews, including appraiser rotation to mitigate bias. Banks are also urged to scrutinize sponsor behaviour, assessing their historical support, liquidity capacity, and strategic intentions, especially in the absence of formal guarantees.
 - At the **governance** level, boards must be equipped with holistic and timely insights into risk metrics, model limitations and the increasing relevance of sponsor support. They are expected to oversee provisioning, evaluate Stage 2 IFRS 9 classification, and steer long-term strategies beyond temporary "amend and extend" arrangements.

