

# “Extend-and-Pretend in the U.S. CRE Market” by **Matteo Crosignani** and Saketh Prazad

Discussion by Christophe Spaenjers (CU Boulder)

SFS Cavalcade  
20 May 2025

# Big picture

## ☆ Commercial Real Estate Prices for United States (COMREPUSQ159N)

Observations ▼

Q3 2024: **-10.47280**

Updated: Apr 1, 2025 7:03 AM CDT

Next Release Date: Jun 2, 2025

Units:

Percent Change from  
Year Ago,

Not Seasonally  
Adjusted

Frequency:

Quarterly

1Y

5Y

10Y

Max

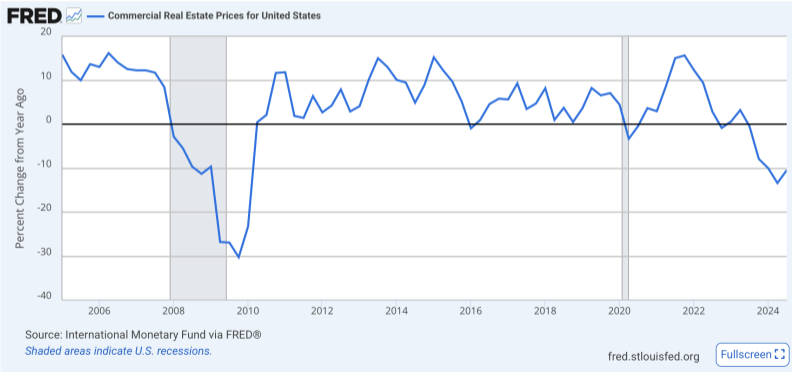
Edit Graph

Download

2005-01-01

to

2024-07-01



# Big picture

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- ▶ Potential for losses for lenders that hold mortgages
- ▶ How do banks manage their distressed assets?
- ▶ Banks extend (maturities) and pretend (that things aren't that bad)

# Big picture

The screenshot shows a webpage from CRE Daily. At the top left is a 'Menu' icon. The logo 'CRE Daily' is in the top center. On the top right, there is a search icon and a purple 'SUBSCRIBE' button. Below the logo, there are navigation tabs for 'BRIEFS', 'National', and 'Landing'. The main headline is 'CRE Still Extending and Pretending as Modifications Hit \$19B'. Below the headline is a sub-headline: 'Despite a struggling market, CRE's "extend-and-pretend" strategy is thriving, with record loan modifications in 2024.' The date 'January 27, 2025' is displayed below the sub-headline. At the bottom left of the article preview, it says 'By CRE Daily Staff and Han Lung' with a small profile picture of Han Lung. On the right side of the article preview is a yellow image featuring a wooden-handled rubber mallet and a red stamp that says 'EXTENDED'.

# Big picture



Menu **CRE Daily**  [SUBSCRIBE](#)


BRIEFS National Landing

## CRE Still Extending and Pretending as Modifications Hit \$19B

Despite a struggling market, CRE's "extend-and-pretend" strategy is thriving, with record loan modifications in 2024.

January 27, 2025

By  CRE Daily Staff and  Han Lung



**COMMERCIAL OBSERVER** INDUSTRY ▾ MARKETS ▾ LEASES ▾ FINANCE ▾ INVESTMENTS ▾ DEVELOPMENT ▾ M

FINANCE · CMBS | NATIONAL

## 'Extend and Pretend' Fastest-Growing CRE Loan Workout Strategy

BY [MIKE HAAS](#) DECEMBER 3, 2024 3:52 PM

## LAWFLASH

# FEDERAL RESERVE BANK PUBLISHES PAPER ON 'EXTEND-AND-PRETEND' WORKOUTS

October 30, 2024

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## Banks' strategy of extending commercial loans found to escalate financial risk

'Extend-and-pretend' approach creates wave of debt that likely won't be paid, New York Fed says

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- ▶ Result: fewer defaults; crowding out of new credit provision; “maturity wall”

# Overview of discussion

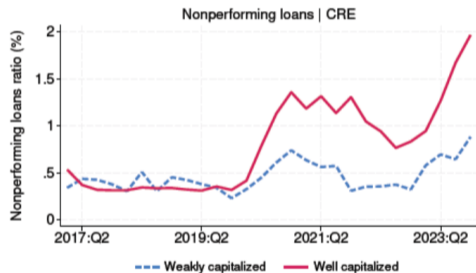
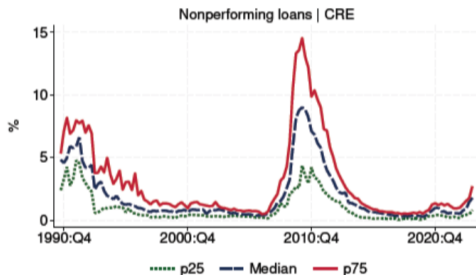
1. Valuations vs. loan performance
2. Which banks and CRE assets are driving results?
3. Interpretation of results
4. Lending terms
5. Crowding-out vs. other counterfactuals
6. Tear down this wall (of maturity)

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- ▶ Paper argues that banks “have been sluggish in assessing the deterioration in CRE” and that “the sluggishness has been driven by weakly capitalized banks”

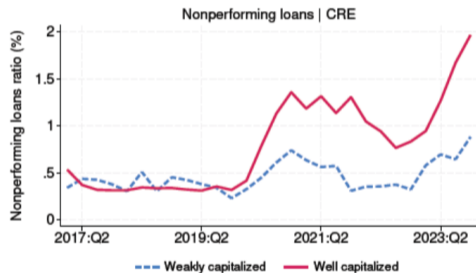
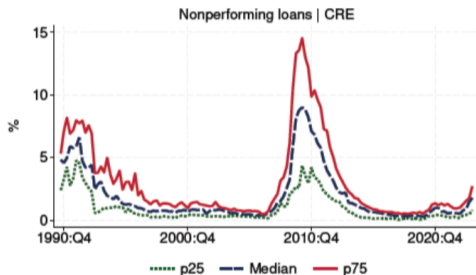
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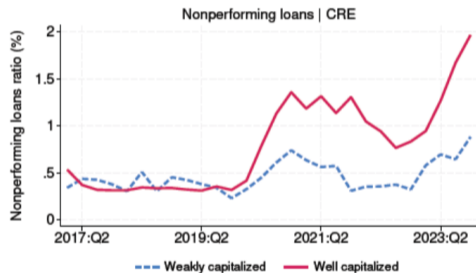
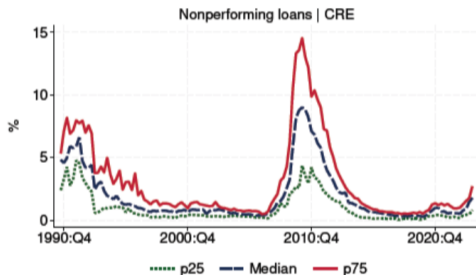
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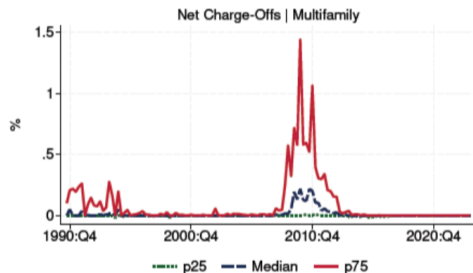
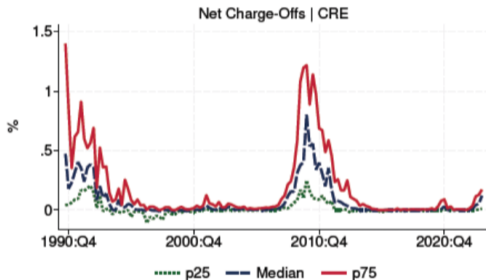
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- ▶ Lower valuations driven by higher interest rates vs. genuinely distressed activities?
- ▶ Problem for many borrowers is not monthly payments but balloon payment that needs refinancing at maturity? So extending might make some sense? Full recovery scenario not far-fetched?

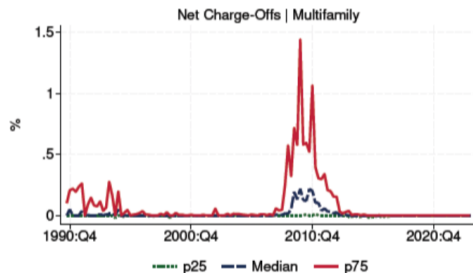
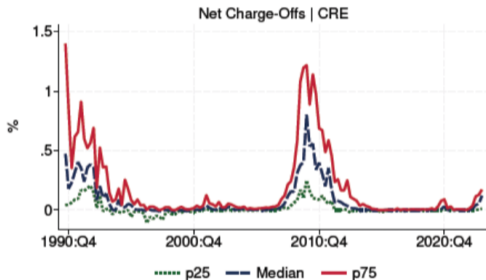
# 1. Valuations vs. loan performance

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- ▶ “Sluggishness” or lack of distress?

## 2. Which banks and CRE assets are driving results?

	Probability of Default			PD <sub>it</sub>
	(1)	(2)	(3)	(4)
Undercapitalized <sub>bt</sub> × Distress <sub>it</sub>	-0.783*** (0.224)	-0.796*** (0.232)	-0.621*** (0.195)	-0.633*** (0.166)
Undercapitalized <sub>bt</sub>	-0.0165 (0.114)	-0.0577 (0.0836)	-0.110 (0.107)	
Distress <sub>it</sub>	3.560*** (0.526)	3.339*** (0.531)	0.598 (0.522)	0.672 (0.471)
<u>Fixed Effects</u>				
Zip Code-Quarter	✓			
Zip Code-Property Type-Quarter		✓	✓	✓
Bank-Quarter				✓
Observations	150,274	123,319	114,817	114,815
R <sup>2</sup>	0.247	0.368	0.378	0.393

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### Assets:

- ▶ Broad definition of distress: NOI lower than at origination → 31% of firms
- ▶ Only 1.8% unconditional default probability for “distressed” borrowers

### 3. Interpretation of results

	Probability of Default			PD <sub>it</sub>
	(1)	(2)	(3)	(4)
Undercapitalized <sub>bt</sub> × Distress <sub>it</sub>	-0.783*** (0.224)	-0.796*** (0.232)	-0.621*** (0.195)	-0.633*** (0.166)
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Zip Code-Quarter	✓			
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Bank-Quarter				✓
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- ▶ Undercapitalized banks not using lower PDs for non-distressed borrowers?
- ▶ At  $Undercapitalized=0$ , distress not correlated with PD?

### 3. Interpretation of results

	Extension <sub>it</sub>			
	(1)	(2)	(3)	(4)
Undercapitalized <sub>bt</sub> × Distress <sub>it</sub>	0.244*** (0.060)	0.199*** (0.034)	0.215*** (0.063)	0.206*** (0.037)
Undercapitalized <sub>bt</sub>	-0.354* (0.179)	-0.433*** (0.114)	-0.442*** (0.136)	
Distress <sub>it</sub>	-0.160 (0.212)	-0.354 (0.199)	-0.626* (0.320)	-0.577* (0.277)
<u>Fixed Effects</u>				
Zip Code-Quarter	✓			
Zip Code-Property Type-Quarter		✓	✓	✓
Bank-Quarter				✓
Observations	150,274	123,319	114,817	114,815
R <sup>2</sup>	0.317	0.466	0.472	0.495

- Undercapitalized banks less likely to extend for non-distressed borrowers?

### 3. Interpretation of results

	New Origination <sub>bzt</sub>			
	(1)	(2)	(3)	(4)
Distressed Extensions <sub>bt</sub> × Undercapitalized <sub>bt</sub>	-0.602** (0.248)	-0.606** (0.242)	-0.582** (0.217)	-0.432** (0.161)
Distressed Extensions <sub>bt</sub>	1.028* (0.511)	1.075** (0.492)	1.252** (0.496)	1.126** (0.400)
Undercapitalized <sub>bt</sub>	0.006*** (0.002)	0.006*** (0.002)	0.062*** (0.020)	0.039* (0.019)
Bank-Level Controls		✓	✓	✓
Bank-Level Controls (interacted with Undercapitalized <sub>bt</sub> )			✓	✓
<u>Fixed Effects</u>				
Zip Code-Time	✓	✓	✓	✓
Bank	✓	✓	✓	
Zip Code-Bank				✓
Observations	140,134	140,134	140,134	135,486
R <sup>2</sup>	0.313	0.313	0.313	0.469

- ▶ Only exploit variation at bank × quarter level
- ▶ How explain main effects of undercapitalization and distress?

## 4. Lending terms

- ▶ Are loans simply extended? Does amortization continue? Does interest rate change? (Or do borrowers get “subsidized” financing?)

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- ▶ LinkedIn!



**Christophe Spaenjers** ✓ · You

Professor of Finance & Real Estate and Faculty Director of the M...

5d · 🌐



I need some help. When a bank extends a CRE mortgage approaching maturity, potentially for a property/borrower in distress ("extend-and-pretend"), do the other terms of the loan change (e.g., new interest rate)? Does this become an interest-only loan or does amortization continue at the same rate?

## 4. Lending terms




**Jeff Peshut** ✓ · 1st

(edited) 5d ...

Assistant Professor of Finance (Real Estate) and Direct...

In a traditional "extend and pretend", the lender "extends" the maturity date of an under-performing or non-performing loan to provide the borrower with more time to get the loan back into a performing status, while at the same time pretending that the loan is not under-performing or non-performing. If they modify the interest rate or amortization provisions, they are acknowledging to regulators that the loan is no longer performing under its original terms and conditions, so extension of the maturity date is generally the only modification. If the lender makes additional modifications, it begins to look like a "workout".



**Ulrike Patig, CAIA**  · 1st

(edited) 5d ...

Strategic Advisory & Business Development Professio...

The changes typically include interest-only conversion, rate adjustments, and modified covenants. The practice has become increasingly prevalent in the CRE sector (office CMBS loan delinquencies reached 11.2% in November 2024, tripling from early 2023 levels, with projections exceeding 14% in 2025) <https://www.ft.com/content/185f7b12-5baf-42c4-bddd-1c723ed90a7b> ... somewhat funny, but no fun statement: "If we continue to see rising delinquencies we will know that these modifications are just not working out."

## 4. Lending terms



**Sergei A. Safiullin** · 2nd

5d ...

PropTech VC, Landmark Developer, and PhD in Economics.

Great question. When a bank extends a maturing CRE loan, the loan terms often do change — but it depends on the bank's risk appetite, regulatory pressure, and the borrower's situation.



**Andreas C.** · 2nd

3d ...

Finance & Real Estate Professor, Startup CEO, Securitization Ri...

Extend and pretend refers to the extension of loan maturity only and no other loan modification (extension risk). Loan interest owed accrues and, depending, may be paid to debt holders/lenders for a period of time by special servicers. However, for those loans that are already extended, there may be a higher probability of additional loan modifications in the future (interest rate or am or both, in addition to the maturity extension) as an alternative to foreclosure. The incentive to foreclose for lenders on failing properties changes in response to many factors including but not limited to (type of lender original lender (CMBS pool or balance sheet), size of loan, current implied value of property, current implied value of loan, loan auction demand, construction and leasing costs, scarcity of new capital provided by lenders and risk restrictions, among others). And thus, the often stated phrase in CRE 'borrow 1mm, you owe them; borrow 100mm they owe you' has a fair amount of truth to it.

Extend-and-Pretend

## 5. Crowding-out vs. other counterfactuals

- ▶ Argument is made that extend-and-pretend behavior hindered reallocation of capital
- ▶ But is a better allocation of capital really the only or most likely counterfactual?

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- ▶ Argument is made that extend-and-pretend behavior hindered reallocation of capital
- ▶ But is a better allocation of capital really the only or most likely counterfactual?
- ▶ Imagine banks did not extend these mortgages... Efficiency of resolution process? Fire sales of properties? Bank runs?

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The maturity wall for CRE is very steep

APOLLO

