

Date: [Insert Date]

To: [Insert Board of Directors/Credit Committee Name]

From: [Insert Risk Management/Chief Credit Officer Name]

Subject: Formal Adoption of Commercial Real Estate (CRE) Stress Testing Policy

Dear [Insert Name/Committee],

This letter serves as the formal policy outline for the Commercial Real Estate (CRE) Stress Testing framework for [Insert Institution Name]. This policy is designed to identify, quantify, and manage potential risks within our CRE portfolio under adverse economic conditions.

1. Objective

The primary goal is to ensure the institution maintains adequate capital and liquidity levels to withstand significant market downturns, interest rate spikes, or declines in property valuations.

2. Scope of Portfolio

This policy applies to all CRE asset classes, including but not limited to:

- Multi-family residential
- Office and Retail spaces
- Industrial and Warehouse facilities
- Hospitality and Construction loans

3. Stress Scenarios

The risk management team will conduct testing based on the following scenarios:

- **Baseline Scenario:** Current economic projections.
- **Adverse Scenario:** Moderate increase in vacancies and interest rates.
- **Severely Adverse Scenario:** Significant decline in Net Operating Income (NOI) and sharp increases in capitalization (Cap) rates.

4. Key Metrics for Evaluation

Testing will focus on the impact to the following metrics:

- Debt Service Coverage Ratio (DSCR)
- Loan-to-Value (LTV) ratios
- Probability of Default (PD)
- Loss Given Default (LGD)

5. Frequency and Reporting

Stress testing will be performed [Insert Frequency, e.g., Semi-annually]. Results will be presented to the Board of Directors to inform strategic decisions regarding concentration limits and capital reserves.

6. Compliance

This policy aligns with regulatory expectations regarding sound risk management practices for concentrations in CRE lending.

Please review the attached technical manual for specific calculation methodologies. We request formal approval of this policy by [Insert Date].

Sincerely,

[Insert Signature]

[Insert Printed Name]

[Insert Title]