



Pretend and Extend: A Deep Dive into Commercial Real Estate Lending's Hidden Crisis

CHAPTER 19: A POST-PRETEND PLAYBOOK – PRINCIPLES FOR HONEST LENDING DECEMBER 15, 2025 | REAGAN SCHWARZLOSE, FRICS | MAI | CRE | CCIM

The extend-and-pretend phenomenon that has characterized commercial real estate finance in recent years was not merely a technical lapse in risk management. It represented a cultural breakdown in which short-term pressures consistently overrode long-term discipline, subjective optimism displaced objective assessment, and institutional incentives rewarded delay over transparency. As this cycle concludes and the industry confronts accumulated losses, the question is not simply how to manage current distress but how to prevent similar patterns from recurring.

The next phase of commercial real estate finance must be guided by shared principles that restore trust in collateral valuation, risk recognition, and workout transparency. Regulations provide necessary boundaries and enforcement mechanisms, but principles establish tone and intent. They articulate what institutions should aspire to achieve, not merely what they must avoid. This article proposes a draft framework of lending principles designed to anchor the shift from extend-and-pretend to honest, transparent commercial real estate finance.

Diagnosis: What Broke

Understanding reform requires acknowledging what failed. The extend-and-pretend era reflected several interconnected breakdowns in discipline and accountability.

Banks delayed revaluations to avoid capital hits and

earnings impacts. When properties declined in value, obtaining updated appraisals would have forced loan-loss provisioning, regulatory capital reduction, and difficult conversations with borrowers and boards. The path of least resistance was to defer revaluation under various justifications, including claims that market conditions were temporarily distorted or that properties would recover value given time.

Valuation inputs were manipulated or selectively interpreted to support desired conclusions. Appraisers faced pressure to use favorable comparable sales, optimistic income projections, or aggressive cap rate assumptions. Internal reviews that questioned valuations were sometimes overridden by lending personnel who argued for more generous interpretations. The result was that reported collateral values often reflected institutional preferences rather than market reality.

Covenants were written loosely and enforced selectively. Loan agreements incorporated generous financial test thresholds, infrequent measurement intervals, and ambiguous definitions that provided flexibility for both parties. When breaches occurred, enforcement was inconsistent, with forbearance granted based on relationship considerations or portfolio management convenience rather than consistent policy frameworks.

Risk teams became marginalized in favor of short-term earnings stability. Credit risk officers who raised

concerns about valuation adequacy or portfolio concentrations were sometimes viewed as obstacles to business objectives rather than essential checks on excessive risk-taking. The institutional balance between business generation and risk management tilted decisively toward maintaining loan volume and fee income.

These failures were not universal, nor were they always deliberate. Many resulted from incremental decisions that appeared reasonable individually but accumulated into systemic problems. The diagnosis is not offered to assign blame but to identify patterns that principled frameworks must address.

The Role of Principles in Market Repair

Regulatory oversight will intensify following this period of stress, and enforcement actions will address the most egregious failures. However, regulations alone cannot create the cultural transformation required for sustained improvement. Prescriptive rules invite creative compliance where institutions meet technical requirements while missing underlying intent. Principles-based frameworks complement regulations by establishing aspirational standards that guide discretionary judgments and institutional culture.

Clear industry norms around valuation transparency can reduce manipulation, improve capital formation, and strengthen stakeholder trust. When major institutions publicly commit to specific valuation principles, they create competitive pressure for others

to match those standards. Borrowers gain confidence that loan terms reflect genuine market assessments rather than optimistic projections that will later prove unsustainable. Investors in bank equity and debt can better assess portfolio quality when they understand the valuation discipline underlying credit decisions. Regulators can examine compliance more efficiently when institutions operate from clearly articulated frameworks.

The Post-Pretend Lending Principles

The following principles provide a foundation for honest, transparent commercial real estate lending that balances prudent risk-taking with disciplined valuation and monitoring.

Valuation Integrity. All loan decisions at origination, renewal, modification, or workout should be based on independent, current-market valuations that are clearly sourced and openly disclosed within credit files. Appraisals must reflect observable market conditions using comparable sales, rental rates, and cap rates from recent transactions. Internal reviews should document the basis for accepting or questioning appraisal conclusions. Borrower-provided valuations may inform discussions but should not substitute for independent assessment.

Risk Signal Transparency. Risk metrics including debt service coverage ratios, occupancy levels, tenant credit quality, and loan maturity status must be monitored continuously and made available to credit officers, risk teams, and regulators through integrated systems. Portfolio dashboards should display these metrics in real time rather than quarterly summaries that obscure interim deterioration. When metrics approach covenant thresholds or historical norms for problem loans, automated alerts should trigger review protocols.

Revaluation Triggers. Standardized events should require appraisal updates or comprehensive risk reviews without institutional discretion to defer. These

triggers should include net operating income decline exceeding defined thresholds, maturity extensions beyond original terms, significant tenant departures, market-level distress indicators such as comparable property sales at materially lower values, and any loan modification that changes economic terms. Revaluation protocols should specify acceptable methodologies and required turnaround times.

Workout Clarity and Communication. Workout strategies must be documented with explicit valuation support and include transparent borrower engagement protocols. When lenders conclude that restructuring is necessary, the basis for that conclusion should be articulated in writing with reference to current property valuations and market conditions. Borrowers should receive clear communication about lender expectations, available resolution paths, and consequences of non-cooperation. Workout terms should be consistent across similar situations to avoid claims of arbitrary treatment.

Capital Discipline. Capital buffers and loan-loss reserves must reflect valuation reality rather than optimistic projections or legacy assumptions. When current appraisals indicate collateral shortfalls, provisioning should occur promptly rather than being deferred pending hoped-for recovery. Stress testing should incorporate realistic scenarios based on observed market conditions rather than mild adjustments to baseline assumptions. Regulatory capital calculations should use current collateral values, not origination-date figures that no longer reflect market conditions.

Regulatory Accountability. Regulators and internal audit teams should test valuation consistency across portfolios and provide public guidance on emerging valuation risk patterns. Examinations should include sampling of recent appraisals with comparison to market evidence and analysis of whether revaluation triggers were properly applied. Regulatory guidance should identify sectors or markets showing signs of

systematic overvaluation and recommend enhanced monitoring. Public communication about examination findings, while protecting individual institution confidentiality, helps the broader market understand regulatory expectations.

Institutional Governance. Senior management and boards of directors must establish clear accountability for valuation discipline and risk recognition. Credit policies should be reviewed and approved at the board level with specific attention to valuation standards and revaluation protocols. Risk committee charters should explicitly assign responsibility for monitoring valuation adequacy. Internal audit plans should include periodic assessment of compliance with valuation policies. Compensation structures should reward long-term portfolio performance rather than origination volume alone.

Path to Adoption

Translating principles into practice requires collective action across the commercial real estate finance industry. Several steps can facilitate adoption and implementation.

Trade associations including the Mortgage Bankers Association and CRE Finance Council should convene working groups to refine these principles and develop detailed implementation guidance. Industry endorsement provides legitimacy and creates expectations that signatories will be held accountable by peers, borrowers, and regulators. Public commitment to principles-based lending distinguishes institutions that embrace transparency from those that continue legacy practices.

Regulators should incorporate these principles into examination guidelines and best-practice memoranda. While stopping short of rigid mandates that eliminate necessary flexibility, regulatory guidance can establish expectations for how principles should inform credit decisions and risk management. Examination findings can reference principles to explain why certain practices are viewed as sound or deficient.

Creation of a formal task force with representation from valuation professionals, large and regional banks, non-bank lenders, and regulatory agencies would provide structure for ongoing development and refinement. This group could publish case studies showing principle application, develop training materials for credit personnel, and track industry progress toward adoption. Periodic public reports would maintain focus and accountability.

Large institutional lenders can lead by example through early adoption and public disclosure of their commitment to these principles. When major market participants demonstrate that principled lending is compatible with profitable business, smaller institutions gain confidence to follow. Early adopters also gain reputational benefits as market participants seek lenders known for transparent practices.

Conclusion: From Crisis to Commitment

The extend-and-pretend era has concluded, leaving behind lessons about what happens when short-term expedience displaces long-term discipline. The path forward requires more than managing current distress. It demands fundamental commitment to valuation integrity, risk transparency, and institutional accountability.

The principles outlined here provide a starting framework, not a final mandate. They require refinement through industry dialogue, regulatory input, and practical testing. What matters is the commitment to establishing and following clear standards that restore trust in commercial real estate finance.

The call to action for bank executives, regulators, credit policy leaders, and risk governance professionals is to engage seriously with principles-based reform. Draft policies that embed these concepts into institutional practice. Participate in industry working groups developing implementation guidance. Hold colleagues and institutions accountable for adherence to stated principles.

Four Corners Valuations stands behind this call for principle-based reform. As independent valuation professionals, we believe market integrity begins with honest, clear-eyed appraisal that reflects observable market conditions rather than institutional preferences. We are ready to assist institutions in aligning their credit culture with these standards through objective valuations, transparent methodologies, and collaborative engagement with credit teams. The post-pretend era begins with commitment to truth in valuation. That work starts now.



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