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Banks Reducing CRE Exposure, Tightening Credit, While Demand Remains Flat

Continued Weakening in Real Estate Markets Increasing Risk, Cutting Demand

As firms continue to downsize, cut costs and reduce inventories, the nation's largest banks are reporting that demand for credit in the commercial real estate market is well below normal levels, according to the U.S. Treasury Department's monthly bank lending survey from the largest 21 recipients of government bailout money through the Capital Purchase Program.

The May survey results released this week found that new loan demand in commercial real estate remains low due to the lack of new construction activity. In addition, developers are reluctant to begin new projects or purchase existing projects under the current deteriorating economic conditions, which include a rising supply of office space as firms downsize and vacancies rise.

Nearly all respondents indicated that they were actively reducing their exposure to commercial real estate loans, as they expect CRE loan delinquencies to increase over the coming year. The outstanding balance of CRE loans of all respondents decreased by 1%, and the median change in outstanding balances was flat.

At the same time, for the month of May, total renewals of existing accounts and total new commitments in commercial real estate increased from April. The changes in renewals and new commitments on the institution level, however, were mixed; 10 of the 17 institutions active in the CRE renewals reported increases in renewals, while seven reported decreases. Nine of the 16 institutions actively making new commitments in the market reported increases in new commitments, while seven reported decreases in new commitments. The median change in renewals of existing accounts was an increase of 2%, and the median change in new commitments was an increase of 11%.

Banks Tighten Underwriting in Response To Rising Risks

Separately, The Office of the Comptroller of the Currency released its annual Survey of Credit Underwriting Practices and reported that commercial and retail underwriting standards tightened for the second consecutive year following a four year period of eased underwriting.

Examiners most often cited the following reasons for tightening of CRE underwriting standards:

- Continued weakening in the economy, specifically, the downturn in real estate markets.
- Declines in market values and prices as a result of oversupply or slow-moving inventory.
- Change in risk appetite based on internal and external factors.
- Performance and quality of loans in the portfolio and accompanying risk associated with those loans.

The 2009 survey is a compilation of examiner observations and assessments of credit underwriting standards at the largest national banks. The survey indicates that the renewed focus on fundamental credit underwriting principles that followed the 2007 market disruption has continued.

The 2009 survey included the 59 largest national banks and covered the 12-month period ending March 31. The aggregate total of loans was \$3.6 trillion, which represented more than 84% of all outstanding loans in the national banking system.

CRE products include commercial residential construction, commercial construction, and other CRE loans. These products are offered by virtually all of the surveyed banks. CRE remains a primary concern among

CONTINUED: Banks Reducing CRE Exposure, Tightening Credit, While Demand Remains Flat

examiners, given the rapid growth of these exposures and banks' significant concentrations relative to their capital. Net tightening, which measures the difference between the percentage of banks tightening underwriting compared with those easing, was greatest in commercial residential construction, followed by commercial construction and other commercial real estate.

Examiners indicated that overall CRE credit risk increased at 96% of the banks since the previous survey and is expected to increase during the next survey year at 98% of the banks.

Thirty-nine banks (or 66%) of the 59 banks in the survey offer commercial residential construction loan products. Examiners noted that the slow-moving home sales and depressed home values are delaying the recovery in the housing market. Certain markets, notably Florida, California, Arizona, and Nevada, have seen a more pronounced deterioration than the rest of the country. Foreclosures continue to escalate, and banks are reducing their exposure in residences with one to four units and condos in light of the weak economic environment and high levels of nonperforming, criticized/classified assets, and losses. The following table shows that 92% of banks surveyed for the 2009 survey tightened underwriting standards for commercial residential construction while none reported easing standards.

Examiners reported that the continued economic downturn, job losses, and a decline in consumer spending are adversely affecting the retail, office and industrial sectors and are receiving elevated attention by 46 of the banks in the survey. Retail properties had the most concerns raised by examiners because of declining consumer confidence and spending levels, weak retail sales, increased store closings, and increased numbers of bankruptcy and liquidations in the retail sector.

Examiners indicated that the multifamily sector seems to be holding its own, however, some major metropolitan areas may see apartment rentals adversely affected by job losses. In addition, the lack of a commercial mortgage-backed securities (CMBS) market has reduced availability of term financing by the securitization market reflecting concern over significant drops in property cash flows and a higher incidence of tenant defaults. The following table shows that 80% of banks surveyed this report tightened underwriting standards for commercial construction while none reported easing standards.

As with commercial residential and commercial construction, examiners reported that this sector's declining values, increasing vacancy and significant reduction in permanent market liquidity has triggered a change in risk appetite. In some cases, failed syndications have resulted in banks retaining a higher level of originated loans on their balance sheets. The following table shows that 76% of banks surveyed tightened underwriting standards for other CRE construction while 2% reported easing standards.

Bank by Bank

Bank of America reported that overall new loan demand for commercial real estate was down due to the lack of new construction activity and the overall conditions of the real estate market. The CMBS market remained closed and the lack of permanent financing continued to put pressure on bank deals. Demand in large corporate through middle market remained soft due to lower top line revenue forecasts and disinvestments in inventory and capital expenses. Also, there was limited demand for acquisition financing.

BB&T reported that overall new loan demand for commercial real estate slowed slightly. Average CRE balances for the month of May, excluding loans originated by BB&T's specialized lending group, were up 2.7% compared to May 2008. Management continued to diversify the total loan portfolio by lowering the overall exposure to real estate-related loans.

Capital One said it continued to increase its commercial real estate portfolio modestly. The office market had softened as firms continue to downsize their staff. The retail market had also softened as many retailers had cut back expansion plans or gone into bankruptcy. Capital One said it was watching rents and vacancies in retail and office space closely. It said there was continued softness in construction and development activity due to limited demand and excess supply in some markets. This has translated into significant declines in new construction projects in all of its markets and cautious growth in other segments.

CONTINUED: Banks Reducing CRE Exposure, Tightening Credit, While Demand Remains Flat

Citigroup reported that average total commercial real estate loan and lease balances rose moderately to \$25.9 billion in May from \$25.5 billion in April. Citigroup continued to renew and roll over existing CRE loans when it was comfortable with the value of the underlying asset and the ability of counterparties to meet their obligations. However, significant weakness in the CRE market has made very few deals viable, Citigroup reported, although its originations increased from \$12.3 million in April to \$102 million in May.

Comerica Bank said commercial real estate renewals and new commitments increased largely due to increases in the mortgage banker finance division.

Fifth Third Bank reported that average CRE balances decreased by approximately 0.3% in May 2009 compared to April 2009. New CRE commitments originated in May 2009 were \$113 million, which was down slightly from \$155 million in April 2009. Renewal levels for existing accounts decreased significantly in May 2009 to \$393 million versus April 2009 at \$617 million.

Fifth Third said it continued to suspend lending on new non-owner occupied properties and on new homebuilder and developer projects in order to manage existing portfolio positions. It said it believed this was prudent given that its expectation for continued negative trends in the performance of those portfolios.

JPMorgan reported lower customer demand, particularly for working capital, continued to impact the overall levels of commercial lending activity. With capital markets opening up from the end of last year, it said clients were turning to stocks and bonds for their capital needs rather than borrowing on credit. Lending also continues to be impacted by higher market pricing of credit risk in line with deteriorating market and company-specific financial conditions. Companies were opting to fund at lower levels or not at all.

KeyCorp said the CRE market outlook continued to be weak. During the month, KeyCorp continued to extend and modify existing credits, given the lack of liquidity and refinancing options in the CRE market. Primary refinancing activity continued to occur in the multifamily space, with Fannie Mae, Freddie Mac and FHA agencies financing these assets.

Marshall & Ilsley said that commercial real estate, construction and development concentrations continued to decline in-line with its goal of reducing its CRE credit exposure.

Northern Trust reported that commercial real estate market continued to be particularly challenging. Developers were regularly terminating plans for office building and retail center projects. Due to the economic stress, corporations were reducing staff, leading to a decrease in the need for additional office space. The sudden downturn in retail sales had caused retailers to reduce expansion plans and there had been a significant increase in the amount of vacant retail space. The market for permanent financing had also deteriorated, so construction loans have remained on the books longer than expected. Northern Trust said it continued to lend on creditworthy projects with strong guarantors.

PNC remains very active in real estate lending to multifamily owners and operators with whom it was leveraging its relationships with agency lenders such as Fannie Mae and Freddie Mac. While most of these programs do not result in loans on our balance sheet, many do require substantial use of capital to support loss-sharing arrangements.

In most other areas of real estate, PNC said the slowdown in the overall market, coupled with the substantial combined exposure of PNC and National City, suggests that aggregate loan balances will be flat at best for some time. Also, as loans made in prior periods mature but can't be paid off due to lack of a viable refinancing market, PNC continued to work with borrowers to restructure and modify their loans. In many cases, that has resulted in loans remaining on its books and consuming capital that would have otherwise become available to make new loan.

PNC said it remains active in underwriting economic development bonds, many of which require letters of credit provided by PNC. These transactions support investments in buildings and equipment and stimulate

CONTINUED: Banks Reducing CRE Exposure, Tightening Credit, While Demand Remains Flat

manufacturing employment.

PNC continued to purchase low-income housing tax credits that provide equity for the construction of low income housing projects. Once again, neither of these activities results in loans on our balance sheet. However, they do inject growth capital into the economy and require substantial use of its own capital base.

PNC also said it continues to underwrite to a moderate risk profile and lend money to customers who have investment real estate financing needs where PNC felt it had an opportunity to expand an existing C&I relationship or acquire a new C&I relationship.

For Regions Bank, the focus in commercial real estate lending continued to be on renewing and restructuring real estate loans with existing clients versus active pursuit of new real estate loans. It said it was working with homebuilder clients to renew their loans as they mature, inclusive of a minimum spread increase requirement and loan restructuring, as appropriate.

Regions' renewal activity with respect to the remaining commercial real estate and construction portfolio included loan restructuring, re-margining, and re-pricing, consistent with the current credit quality of the sponsor, the performance of the project and the current market. Its underwriting criteria continued to reflect the risk of declining property prices and stressed cash flows. Refinancing into permanent loans and property sales remained at historically low levels. In May, new loan demand remained low. Developers were reluctant to begin new projects or purchase existing projects under current economic conditions, Regions reported.

SunTrust reported that average commercial real estate loans increased approximately 1.1% in May, to \$24.7 billion compared to the April average. New residential home builder loan demand is negligible and demand is lower for commercial transactions as property prices were trending downward and reported investment activity had declined. Owner-occupied commercial loans secured by real estate have remained fairly stable.

U.S. Bancorp said overall new loan demand for commercial real estate remained low due to the lack of new construction activity and the condition of the real estate markets. Its investor and developer portfolio had historically focused on construction lending, so new deal requests have decreased, but bridge or short-term financing was still in limited demand. The lack of a permanent or CMBS market continued to bring clients to the bank to seek short-term financing of completed projects, U.S Bancorp reported, but add that in the last quarter, requests even for this type of bridge financing had witness a decline. In general, its underwriting standards tightened somewhat to reflect the uncertainties in the market.

Bank CRE Lending Activity

(Ranked by Amount of New Business)

Bank	CRE Renewal (in millions)		New CRE Commitments (in millions)		
Wells Fargo	\$2,592	\$2,325	JPMorgan Chase		\$419
\$531	Bank of America	\$2,459	\$523	BB&T	\$1,144
\$429	Regions	\$1,590	\$327	U.S. Bancorp	\$874
\$327	PNC	\$661	\$266	SunTrust	\$340
\$251					
Fifth Third	\$393	\$113	Citigroup	\$73	\$102
Comerica	\$432	\$95	Capital One	\$100	\$83
North Trust	\$3	\$66	Goldman Sachs	\$13	\$40
Marshall & Ilsley	\$56	\$33	KeyCorp	\$593	\$31
Bank of New York Mellon	\$196	\$21	CIT	\$0	\$0
Morgan Stanley	\$0	\$0	State Street	\$0	\$0
American Express	n/a	n/a	Total (All Institutions)		\$11,938
\$5,562	Change in Total (All Institutions)		3%	11%	

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CONTINUED: Banks Reducing CRE Exposure, Tightening Credit, While Demand Remains Flat

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