# HOW BAD IS CRE AT BANKS?

by Steve Brown

We have updated our recently-launched The BIG CRE Index(R) (Index) for the 1Q and find that community banks are projected to see worsening loan quality in coming quarters. While this isn't new information, some of the details behind our Index are. For those of you that are not familiar with the Index, after 2Ys of tracking, we publicly released this benchmark last month.

The Index is calculated based on data from leading third-party providers and collected through the Loan Pricing Model used by community banks across the country. The Index looks at both macro economic factors, as well as specific probabilities of default in each category. These factors include (but are not limited to) employment, income, rents, vacancy and absorption rates. The Index incorporates both historical averages (short and long term), as well as forward projections, in an effort to give lenders and management a quantitative view of the CRE marketplace. It is the nation's only forward-looking benchmark of relative strength of the debt aspects of CRE market conditions for community banks.

Overall in the 1Q, the Index fell to 80.58 from 90.50 in 4Q - a sharp 10.9% decline. The drop was due to weakening economic conditions and an across-the-board deterioration in the retail, industrial, office and the multifamily markets. Since its peak in 2007, the Index shows CRE lending conditions for community banks have eroded 19.4%. This is bad, but it is not as catastrophic as many have been saying. Undoubtedly this puts more pressure on credit quality, but extreme deterioration seen in the residential sector has not carried into CRE. This is due to multiple factors, but one is that CRE is usually supported by multiple revenue sources and as such, has more diversification than single tenant residential properties.

In addition to providing a view into general sector trends, the Index can help bankers allocate resources to sectors that need help the most. Recently, risk to loans on industrial properties are rising the most, due to a sharp contraction in the need for warehouse and manufacturing space. Hardest hit are certain port cities that have been exposed to declining foreign trade.

For community banks, the Index projects the largest CRE risk is exposure to retail, followed by office. Here lending risk is up 11% from 4Q, as both rents and occupancy levels have dropped. Multifamily, has been one of the most stable credit quality sectors, but as previously reported, 1Q saw the sector's first material drop in credit quality (-6.15%).

Regionally, almost every metro area has seen a decrease in credit quality. The lone exception is Washington D.C., which recorded a slight improvement in risk due to the demand created by the change in the Administration. Other special mentions include Boston, which was the only area to record a decrease in credit risk for the retail sector, and San Francisco (which was stable in all sectors except office).

We get questions all the time as to why banks need a good pricing model. As the 1Q data shows, the distribution of credit risk is greatly expanded and all CRE lending is not the same. In Phoenix, for example, lending on industrial properties is projected to remain reasonably strong, while office financing is projected to be problematic. Furthermore, zip code differences within cities like Los Angeles, New Jersey, Chicago, Philadelphia, San Francisco and Seattle are wide.

If you would like to incorporate the latest risk data (including residential, C&I and other lending categories) into your lending decisions, you need our Loan Pricing Model. To monitor the Index, go to: https://www.bancinvestment.com/tools/loanpricing/cre-index.html

# BANK NEWS

**M&A**

United Financial Bancorp ($1.24B, MA) has outbid Berkshire Hills Bancorp's offer of $19.5mm to purchase CNB Financial Corp ($295mm, MA) at $22.8mm.

**TARP Insurance**

The Treasury will provide 6 major insurance companies access to TARP funding. These companies include Prudential Financial, Hartford Financial, Allstate, Principal Financial, Ameriprise Financial and Lincoln National. Numbers for each are still being decided, but all-told, Treasury is expected to inject $22B into the insurance industry.

**Great Job TED**

Actions by global central banks since the crisis began have finally brought the so-called TED spread back to its lowest level since Aug. 2007. The TED measures the yield difference between 3M Treasuries and 3M Libor as a proxy for what major banks pay in comparison to the Treasury to borrow money. The wider the spread, the more risk in the system; the narrower the spread, the more banks are willing to lend to one another and the more liquidity in the system.

**This is a Holdup**

An FDIC analyst on leave from the Agency allegedly attempted to rob a bank in Kansas.

**Troubles to 2013**

S&P projects the nation's banking crisis may extend through 2013.