Opportunities in CRE Lending as Big Banks Retreat

industry update CRE

Summary: CFIs are stepping up and filling the gap as larger players in the financial industry reduce their commercial real estate lending. Are the benefits of CRE lending worth the risks for CFIs?

The American Dream mall in New Jersey recently missed an $8MM loan payment. This misstep follows a difficult couple of years for the mall, which was forced to close only months after opening in late 2019, due to the pandemic. Since reopening, the mall has continually struggled to attract shoppers.

Challenges in commercial real estate (CRE) have increased lending risk, causing big banks to become more cautious. The American Dream mall's missed loan payment is just one example of this trend. Community financial institutions (CFIs) can leverage a unique opportunity in the CRE lending market left by exiting lenders.

Big banks are taking a cautious approach to CRE.

The banking industry has cut back on lending for commercial real estate over a variety of concerns.

The first is economic uncertainty. CRE loans are usually large, and the business world can be unpredictable. Compared to other types of lending, like home mortgages, CRE lending is usually riskier. Uncertainty in the current economic climate has caused lenders to be wary about taking commercial-based risks.

In addition, the ongoing growth of e-commerce has reduced the demand for physical retail space while the pandemic nearly gutted the hospitality sector. Such shifts have forced lenders to become more strategic and selective in their lending practices.

Smaller lenders answer the call for CRE lending.

CFIs are generally more flexible than larger institutions and can respond more quickly to changes in the market, making them the ideal solution to the gap in CRE lending.

CFIs also tend to have insight into their local real estate market, which can be an advantage when lending to local developers and business owners. With a better understanding of the local economy and community, you can reduce your risk substantially.

Finally, smaller institutions often have strong connections with their borrowers, which can benefit the CRE market since small businesses needing commercial lending prefer to turn to CFIs over large institutions.

What does the future of CRE lending look like?

It's difficult to predict the future of the CRE market. However, one trend is an increased demand for flexible office space. Lenders may need to offer more flexible financing choices, like shorter-term loans, to adapt to this shift.

Another trend to watch is the continued growth in e-commerce and industrial real estate. The pandemic has accelerated the growth of e-commerce. As a result, the demand for industrial real estate, including warehouses and distribution facilities, is likely to rise.

The hospitality and retail sectors may also gradually recover post-pandemic, but the pace will likely vary by region. This gives CFIs a unique opportunity to leverage their knowledge and understanding of the local economy to support borrowers.

Assess the rewards and risks of CRE lending for CFIs.

CRE loan interest rates range from 2.2% to 18%, offering attractive returns while helping CFIs expand their loan portfolios. Lending to well-qualified borrowers can also help you build strong relationships with their clients and support local economic development, boosting brand recognition and reach.

On the other hand, CRE lending is riskier than other types of lending because of the size and complexity of each loan. Additionally, lending regulations are stricter in the commercial real estate market, making it hard for smaller lenders to compete with bigger ones (even if there are fewer to compete with).

Despite these challenges, you can take steps to mitigate risks in CRE lending, such as carefully underwriting loans and diversifying their portfolios. You can also lean on your expertise in the local market to mitigate risk and take advantage of the commercial borrower’s preference for small over big to gain a competitive advantage over larger institutions.

There are both risks and rewards tied to CRE lending for CFIs. Ultimately, the decision to provide CRE lending on a larger output must be based on a thorough analysis of the risks and rewards and your organization’s overall strategy and risk appetite.

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ECONOMY & RATES

Rates As Of: 04/14/2023 11:57AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.10	0.25	0.68
6M	4.95	0.01	0.19
1Y	4.76	0.16	0.06
2Y	4.08	0.06	-0.34
5Y	3.61	0.03	-0.40
10Y	3.52	0.05	-0.36
30Y	3.74	0.09	-0.23

FF Market	FF Disc	IORB
4.83	5.00	4.90
SOFR	**Prime**	**OBFR**
4.80	8.00	4.82