



Residual CRE Impact From The Pandemic

stress testing pandemic CRE

Summary: Bankers are waiting with bated breath to see how commercial real estate portfolios will land now that some economic recovery seems to be underway. We detail some of the continuing challenges to CRE — retail, remote work, and inflation — along with our thoughts on the effects of these challenges to help with your plans for the future.

Apparently, the proverb “speech is silver, silence is golden” came from the Arabic culture through Spain and then into Germany. It finally made its way into American vernacular from German immigrants in the 19th century.

One topic where silence may not be golden is on the state of commercial real estate (CRE). As we finished our first quarter discussions with bankers, it appears that many bankers are silently waiting to see what will happen to their CRE portfolios.

As the economy recovers, let’s summarize the pandemic-driven challenges to CRE and see where things could be heading.

Retail. The pandemic drove one of the last hold-out consumer segments, older customers, to adopt e-commerce as the safer option for shopping. Now that the barrier has been breached, a significant number of older customers are likely to continue online shopping and this is likely to negatively affect small businesses.

Remote work. Late last year, [McKinsey Global Institute analyzed](#) 2K tasks, done in 800 jobs and looked at not only the immediate impact of the pandemic, but also longer-term factors that impact work, such as automation, AI/machine learning. Their conclusion was that *“more than 20% of the workforce could remotely work 3 to 5 days a week as effectively as they could if working from an office. If remote work took hold at that level, that would mean 3-4x as many people working from home.”*

The most likely professions for remote work include finance, management, professional services, and information (IT & Telecom) sectors. The McKinsey analysis showed that over 50% of the time spent on these jobs could be done remotely with no productivity loss.

On the flip side, just over half of the workforce has less opportunity, or if given the opportunity, the quality of work could suffer. The professions least likely to work remotely include hospitality, education, transportation and warehousing, manufacturing, and healthcare. Because of this, CRE valuations are expected to be less impacted in these sectors.

Inflation. It’s coming. While recent trends have seen a slight flattening of rates, longer-term rates are expected to rise by year’s end, putting further pressure on your borrower’s ability to refinance.

If you’ve cut your CRE exposure in retail, focus on healthcare and manufacturing, and structure longer deals. Also, look to increased vacancies in your community as they are likely to create a dampening effect on the values of the properties in your portfolio. Unless you are located in one of the high-growth suburbs of Phoenix,

Austin, or Raleigh-Durham, you need to know — before your regulator asks you — how these longer-term trends in CRE could affect your institution and your capital ratios.

The risk may not seem apparent as we are awash in liquidity with relatively low rates today, but we are still in a period of high volatility. Given what is projected to be strong growth for the remainder of the year, will that growth support or bypass your CRE portfolio? Do you know how these trends will affect your community and, by extension, your portfolio and the adequacy of your capital ratios? If not, it's time again to stress test your portfolio, using scenario-based stress testing.

In the quick, scenario-based stress testing, regression analysis is used to forecast loss rates, driving losses through the balance sheet to gauge capital adequacy. If the more rigorous sensitivity-based stress test isn't required, a speedy, top-down scenario-based stress can give you answers on tomorrow's trends. Contact us today if you need help with this.

STRESS TESTING: TOP-DOWN OR BOTTOM-UP

In this market, it is important to stress test your loan portfolio. We offer multiple approaches that will fit your needs and your regulatory compliance requirements. Quickly stress test your loan portfolio and get pre-exam assistance. Learn more about [stress testing](#) today.

ECONOMY & RATES

Rates As Of: 04/28/2021 05:13AM (GMT-0700)

| Treasury | Yields | MTD Chg | YTD Chg |
|-----------|---------|---------|---------|
| 3M | 0.01 | -0.02 | -0.08 |
| 6M | 0.04 | -0.01 | -0.05 |
| 1Y | 0.06 | 0.00 | -0.05 |
| 2Y | 0.18 | 0.01 | 0.05 |
| 5Y | 0.89 | -0.05 | 0.53 |
| 10Y | 1.65 | -0.10 | 0.73 |
| 30Y | 2.31 | -0.11 | 0.66 |
| FF Market | FF Disc | | IORB |
| 0.07 | 0.25 | | 0.10 |
| SOFR | Prime | | OBFR |
| 0.01 | 3.25 | | 0.06 |

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