

Commercial Mortgage Defaults in 2010: Hard Times For Some Banks

Hackettstown, NJ, January 12, 2010. Commercial mortgage defaults will be highly elevated in 2010 and could wipe out profits at a number of U.S. banks.

But it does not appear that this problem will morph into a true crisis that would endanger U.S. or global financial systems.

These are the key conclusions of a research study published today by SMR Research Corp. It is entitled **The Commercial Mortgage Dilemma: Banking's Next Credit Challenge**.

"The saving grace for the financial system is that most really large U.S. banks are modestly exposed," said SMR President Stuart A. Feldstein.

For example, highly delinquent commercial mortgages recently were only 0.1% of Citigroup's assets. JP Morgan Chase also appears "walled off" from the dilemma. Exposure at Bank of America is just slightly higher. None of the nation's largest banks risk failure due to commercial mortgage defaults, SMR noted.

The same cannot be said for some medium-sized and smaller banks. At small banks with less than \$1 billion of assets, commercial mortgages recently were 32.5% of total assets – a level of dependence six-fold higher than at big banks with \$50 billion or more of assets.

As of September 30, 2009, 154 banks had highly delinquent commercial mortgages equal to 3% or more of their total assets. In a reasonably good year, banks earn profits of only about 1% of assets. Many of these institutions will be hard-pressed to make any money in 2010, SMR said. Some could become insolvent.

The study includes specific 2010 risk rankings for each of the nation's 477 largest bank holding companies.

As of late 2009, the 90-day-plus delinquency rate on all commercial mortgages (including multi-family apartment building loans and commercial construction loans) was rising fast. It reached 5.59% on September 30, up from 3.51% just six months earlier.

Meanwhile, the vacancy rate on apartment buildings had reached its highest level since at least 1965. Vacancy rates were high as well at shopping centers and office buildings. The total commercial mortgage loan market was \$3.4 trillion as of the third quarter of 2009.

Despite the gloom, SMR found reasons for cautious optimism.

Among them: The early-stage delinquency rate on commercial mortgages appears to have peaked in the first quarter of 2009.

In addition, overall delinquency and write-offs on commercial mortgages were still below levels seen in the last commercial lending crisis in 1991.

"If the economic recovery continues apace, the new commercial mortgage crisis may peak in 2010 and improve in 2011," Feldstein said.

SMR utilized more than 150,000 regulatory financial reports from banks and thrifts to present an 18-year history of commercial mortgage credit figures, from 1991 to 2009.

The firm also tapped its property records database to calculate recent foreclosure rates on commercial properties by type, by state, and by metro area.

Multi-family apartment buildings had the highest foreclosure rate. Properties dependent on consumer discretionary spending – including greenhouses and car washes – also showed high foreclosure rates.

Foreclosure rates were low at churches, medical buildings, funeral homes, and private schools.

Some local markets with high home foreclosures also had high commercial foreclosures, including Arizona and Florida. But the correlation wasn't perfect. Hawaii, for example, showed a high commercial foreclosure rate as the falloff in tourism clobbered hotels and restaurants.

The SMR study spans 130 pages and is available to clients in print and electronic versions. Free copies are not available, but SMR personnel are available for interviews.

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Founded in 1984, SMR Research Corp. is the nation's largest provider of industry research studies on lending subjects. More details about the new study's content can be found by following this link: www.SMRresearch.com.