



Real Estate Lending Risks Monitor

Federal Reserve Bank of San Francisco

Housing: Will This Spring Bump Continue?

Commercial Real Estate: Maturing Loans Remain a Concern

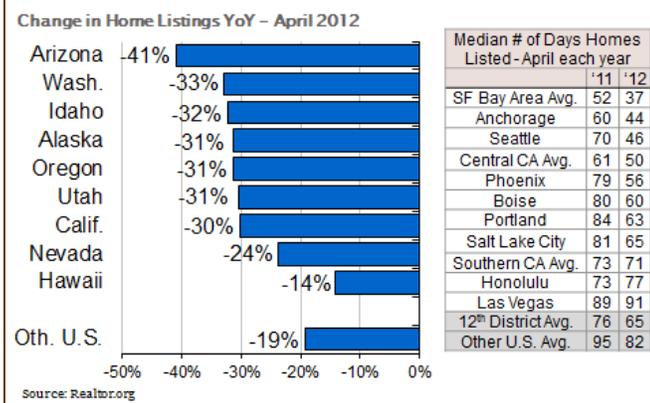
Figure 1: A prerequisite to a housing turnaround is the shrinkage of home inventories available for sale. Fortunately, this appears to be happening. Based on the latest Realtor.org data, home listings fell 30% or more across most of the western U.S. in April 2012 from a year earlier. This pace of inventory reduction was significantly faster than the 19% decline for the rest of the nation. The median number of days homes have been listed on the market also fell significantly in major MSAs in the West year-over-year. Anecdotal reports abound of strong investor demand, multiple offers, and over-bidding in many sought-after areas.

Figure 2: While home prices have not been able to sustain positive momentum in the past six years, the declining inventory levels suggest that prices may be poised to move higher. In fact, over the three-month period February-April, median prices are up at least 4% in Arizona, Idaho, Hawaii, Utah and California. On a year-over-year basis, median prices edged up as well across most of the West. While median existing home prices are still sharply down from their peaks (e.g. Mountain and Pacific regions are down 39% and 38% respectively), and this is worse than the nation (down 32%), the recent price trends in these regions as well as for the nation are the strongest Feb-April appreciation rates in seven years. While this is positive and may signal that the bottom has been reached, the recovery of prices likely will remain slow and bumpy with the weak economy and a still high foreclosure backlog.

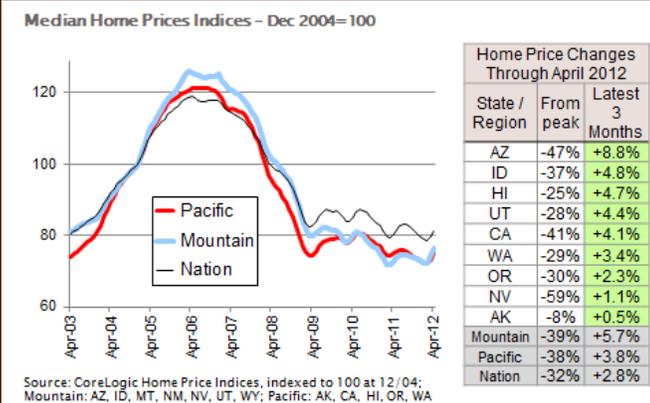
Figure 3: One factor helping housing has been the reduction of shadow inventory, shown in Figure 3 as the rate of delinquent and in-foreclosure loans that continues to fall in most 12th District states. The states with the strongest improvement are those that were most impacted by the housing downturn: Nevada, Arizona, and California. Distressed loans increasingly have been resolved via short sales in those states. Washington is the only District state where the overall rate of mortgage loans past due 60+ days or in foreclosure rose in recent periods. Problem mortgage rates in the Northwest generally did not get as high as in the rest of the District, and the mortgage recovery there appears to be lagging.

Figure 4: Commercial real estate market conditions have improved slowly with recovering occupancy rates and with rent growth turning positive across sectors in most MSAs. Additionally, property values have trended up. As of March 2012, the Moody's/RCA "major markets"

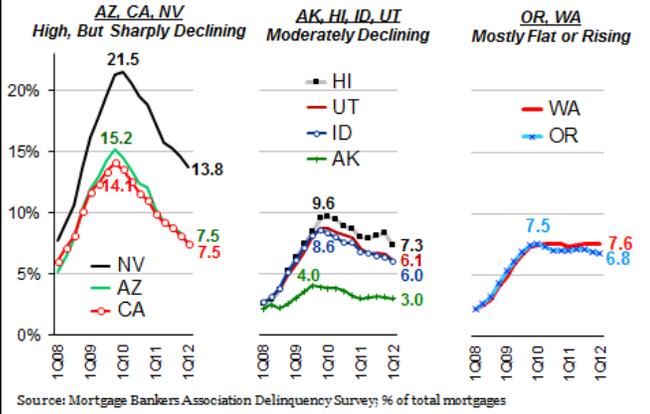
1) Housing May be Bottoming Out, with Reduced Inventories for Sale, Especially in the West



2) Home Prices Remain Sharply Below Peaks, but Recent Data Provide Some Optimism



3) Mortgage Delinquencies Remain High but Have Trended Down (loans past due 60+ days or in foreclosure)





RE Lending Risks Monitor, p.2



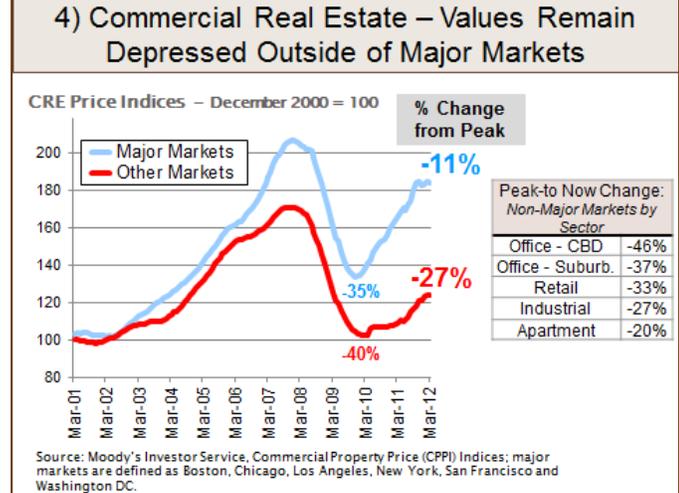
aggregate CPPI index was only 11% below the late 2007 peak, and the non-major markets “other” aggregate index was improved significantly from 40% to 27% below peak. Improving fundamentals and resurgent investor demand has helped bid down cap rates and boost values. Regional appraisal-based data suggests that CRE prices have gained positive momentum across most of the West, particularly in the SF Bay Area, while remaining slow to recover in areas with weaker local economies, like Las Vegas, Phoenix, and Sacramento. However, price recovery has slowed in recent quarters, and further price declines are possible if U.S. job growth remains weak or if turmoil in Europe worsens materially. Net operating income in some commercial sectors has been falling recently, another factor that could depress prices.

Figures 5 and 6: Banks headquartered in the 12th District reported very modest credit loss rates on multifamily and other income property loans of 0.4% and 0.6% respectively in 2011. These were the lowest credit loss rates by lending category aside from ag/farmland loans. Credit losses were low in part due to improving market fundamentals and property values, and to banks’ willingness to work with borrowers of distressed properties and to grant renewals and extensions to minimize losses. Many extensions over the past 1-2 years will end up being successful as market conditions and capital availability for CRE has improved (and should continue to improve) gradually.

However, not all extensions will be successful, and banks now are facing even greater volumes of maturing loans originated near the peak of the market in 2007. Many of these loans are left with little or no borrower equity. Also, leases signed during the boom period typically are being renewed at lower market rates, reducing property NOIs, a problem compounded by lower occupancy rates now compared to five years ago. As these loans mature, banks may find it increasingly difficult to grant renewals or extensions without a third-party property recapitalization and/or loan restructuring.

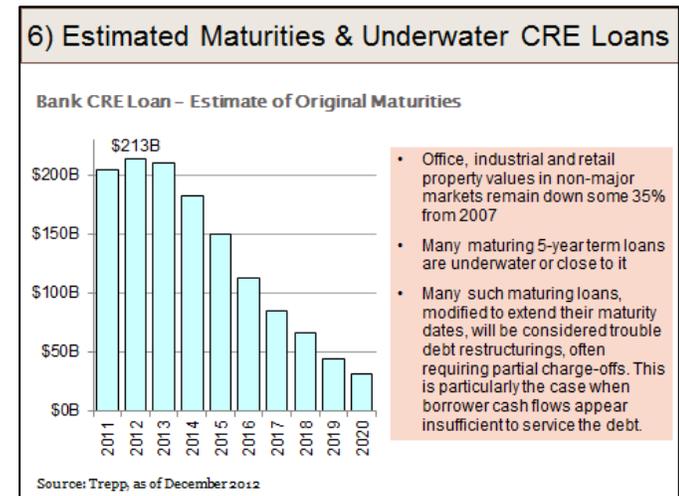
Summary: Housing appears to be turning the corner, although the pace of recovery likely will be slow due to the sluggish economy and still high levels of shadow inventory. If the current “spring bump” in home prices continues and expands to more geographies, mortgage delinquency/foreclosure rates may fall at a faster pace.

CRE markets also are improving; but the price deflation, weakened loan repayment capacities, and large numbers of 5-year balloon mortgages maturing, suggest that credit losses at banks may be significant in the next year or two as distressed situations are addressed.



5) Recent Maturing CRE Loan Headlines

- Buckle Up, The 2007-Vintage Loan Maturities are Coming** Standard & Poors, Dec 15, 2011
- Prospects Dim for Take-Out Financing on 2012 Loan Maturities** CoStar Group, Dec 21, 2011
- Anxiety Mounts Over Maturing Real Estate Loans** NY Times, Jan 24, 2012
- Troubled CRE Loans in the Banking System** Real Estate Center, Texas A&M, Mar. 29, 2012
- Less than 35% of 2007 Loan Maturing This Year Seen Getting Refied** Commercial Real Estate Direct, Jan 11, 2012



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