



Real Estate Lending Risks Monitor

Federal Reserve Bank of San Francisco

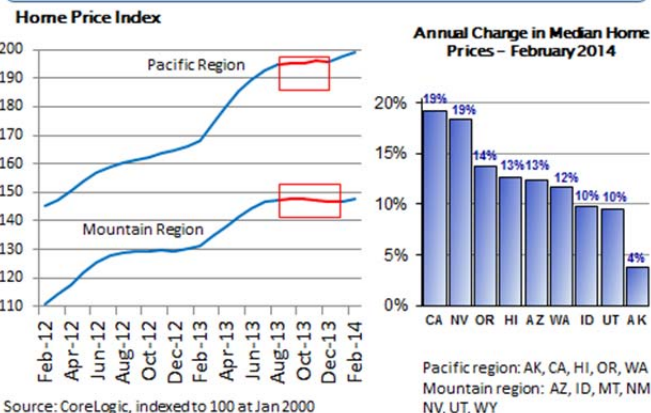
RE Market Conditions in the West: Healthy or Getting There

Figure 1 - Housing: After nearly two years of impressive price appreciation, home prices slowed to a crawl in late 2013. Prices began to rise again in early 2014, but the housing recovery is facing headwinds. Affordability is falling due to a combination of rising prices and mortgage rates as well as weak growth in median household income. There are relatively few first-time home buyers due to tight underwriting requirements, including high down-payment amounts. Investors are also largely out of the market in many areas, not seeing opportunities at these higher prices. Supply constraints look to be gradually easing, with single family home starts trending higher, and more existing homes up for sale. On a positive note, improving economic growth should provide enough of a tailwind to keep prices rising moderately despite these challenges.

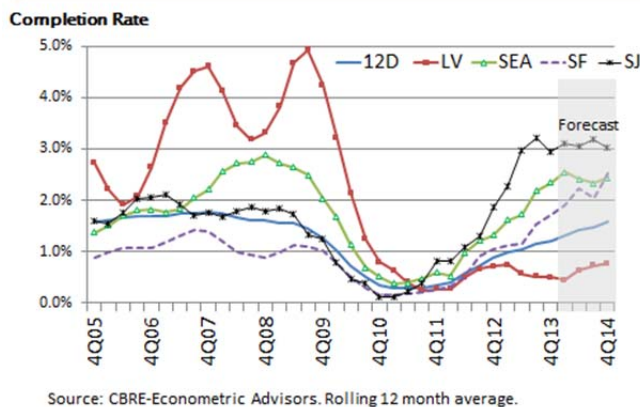
Figure 2 - Apartments: The apartment sector continued to outperform all other commercial real estate sectors. According to CBRE-EA, 12th District rents rose 4% over the past year. Oakland and San Francisco saw the largest YoY rent increases, up 6.9% and 6.7%, respectively. The 12th District large CBSA vacancy rate has plateaued at just above 4%, higher than the 2006 low of 2.8%, but is still considered low based on historical data. At year-end 2013, Oakland had the lowest vacancy rate in the 12th District at 2.9%. These strong fundamentals are fueling apartment construction. Completions in San Jose and San Francisco are now significantly above pre-financial crisis levels. Fortunately job growth in these markets is creating enough demand to fill the new apartments.

Figure 3 - Office: Office fundamentals have improved slowly since the end of the financial crisis. The key to the improvement has been subdued construction. Markets where finance and other housing-sector related office jobs are slow to recover have seen very little new construction. But even in markets such as San Jose, San Francisco, Seattle, and Salt Lake City, where the technology sector has driven robust job growth, construction remains below trend. Based on investment grade office properties followed by NCREIF, net operating income (NOI) within the 12th District has generally trended up. However, in Phoenix, NOI has declined for most of the past two years, primarily related to the high vacancy rate (exceeding 20%). CBRE-EA forecasts very modest vacancy rate declines for Phoenix and NOI is not expected to improve in the near term.

1) Home Prices up Again After a Brief Pause



2) Apartment Completions are Rebounding



3) District NOI Trending Up, but Phoenix is Not Yet Rising

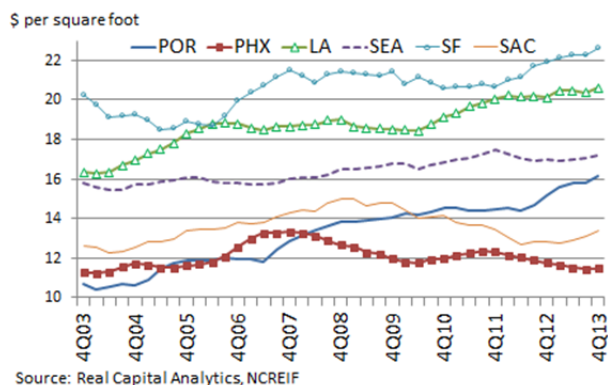




Figure 4 - Retail: According to CBRE-EA, retail availability rates have been edging down in the 12th District as the economy has gradually improved. The 4Q13 aggregate 12th District retail availability rate was 10.9% down from a peak of 11.8% in 1Q12. The high and low availability rates based on most recent data were 16.2% in Las Vegas and 5.8% in San Francisco. The strengthening in this sector has helped reduce the level of troubled retail properties nationally to \$15.6 billion from a high of \$22.3 billion in 2Q11. Despite this improvement, retailers continue to shutter stores. JC Penney announced plans to close 33 stores by May 2014, but of the 217 stores in the 12th District only one is on the closure list. RadioShack will close up to 1,100 of its 5,000+ stores with a potentially much larger impact on 12th District retail space.

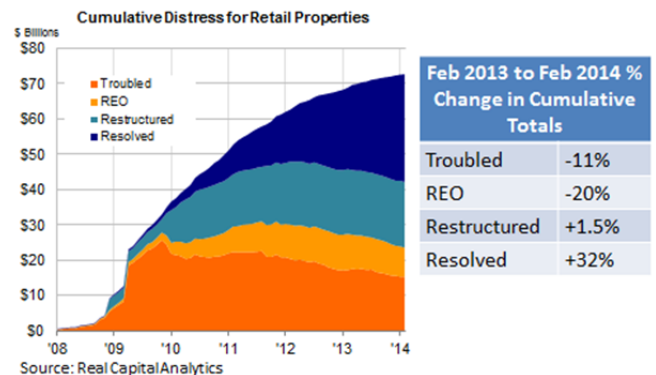
Figure 5 - Industrial: Performance in the industrial sector differs significantly between warehouse and R&D space. Demand for R&D properties has been constrained by weak employment growth among small and mid-sized firms. Stronger warehouse demand comes from growth in distribution facilities which favor large, high quality space over small, lower quality properties. As of year-end 2013, the lowest warehouse availability rate was in Orange County (6.2%) and lowest R&D availability rate was in Los Angeles and Salt Lake City (7.6%).

Figure 6 - Lending: The strong fundamentals in the multifamily sector have spurred significant lending. The 12th District bank aggregate year-over-year multifamily loan growth was 15% in 2013. Nonfarm nonresidential (NFNR) loans grew 7%, and construction land development (C&LD) grew 5%.

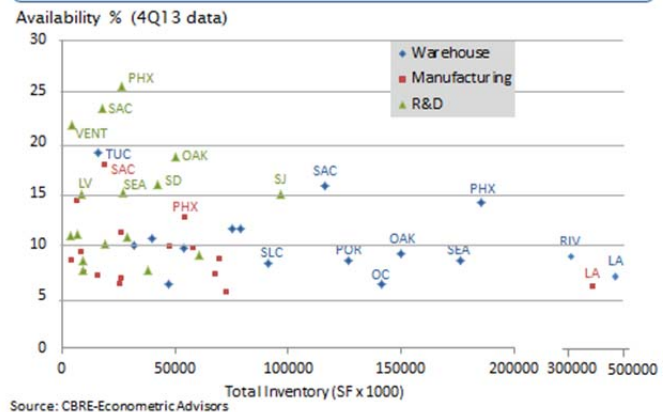
RE Lending Risks: A Summary

The sizzling residential housing market is showing signs of cooling-off, but continuing economic growth should sustain a more moderated pace of appreciation. CRE market fundamentals are healthy and/or recovering throughout most of the 12th District. The drivers are low levels of construction (except apartments) and improving economic growth. Forecasts call for continuing improvement in 2014. Bank lending risks have declined substantially over the past few years, and most problem assets have been resolved and removed from balance sheets. Issues worth monitoring are 1) the possible impact of rising adjustable loan rates on borrowers' ability to pay, and 2) rapid rates of loan growth at some financial institutions, particularly on multifamily properties. Recent Fed Senior Loan Officer Opinion Surveys found that, on net, institutions have eased lending standards for most types of CRE loans in recent periods. Such eased standards historically factor into accelerated loan growth and rising credit problems at some institutions.

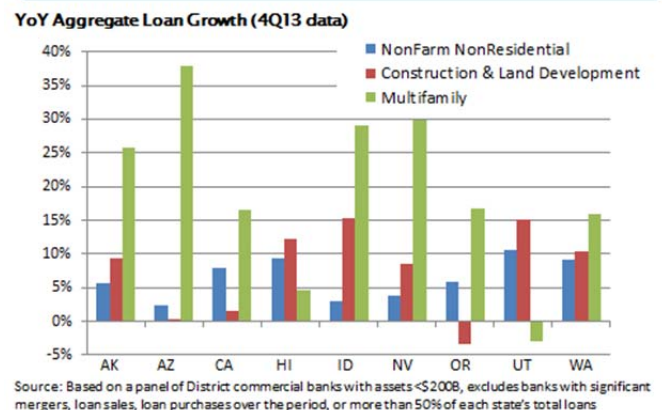
4) Troubled and REO Retail Properties are Receding Across the Nation



5) R&D has Higher Availability than Warehouse



6) Multifamily has the Strongest Loan Growth



Contact: Martin Karpuk: martin.karpuk@sf.frb.org
 Gary Palmer: gary.palmer@sf.frb.org

Division of Banking Supervision and Regulation
 Federal Reserve Bank of San Francisco
<http://www.frbsf.org/banking-supervision/publications/>