There is some concern that the CRE market is facing similar challenges to 2008-2009. In our opinion there are several mitigating factors that distinguish the current situation in CRE (UBS)

Despite challenges in the CRE market there are some potential silver linings

21 March 2024, 6:49 pm CET, written by UBS Editorial Team

With the collapse of several banks in 2023 and the challenges currently being faced by New York Community bank there is some concern that the CRE market is facing similar challenges to 2008-2009. In our opinion there are several mitigating factors that distinguish the current situation in CRE from events in 2008-2009:

With the collapse of several banks in 2023 and the challenges currently being faced by New York Community bank there is some concern that the CRE market is facing similar challenges to 2008-2009. In our opinion there are several mitigating factors that distinguish the current situation in CRE from events in 2008-2009:

Dry powder Private equity is sitting on a significant amount of unlevered dry powder (over $400B), targeted for investment in the CRE market. PE Firms that raised this capital are not paid to manage cash and the weight of this capital sitting on the sidelines tells us it will likely begin being deployed in earnest beginning in 2024. 80% of this capital is oriented towards value-add, opportunistic, and debt strategies. 65% is dedicated to the US CRE market.

Capital Markets: One of the unfortunate hallmarks of the GFC was the effective shutting of the capital markets. We recognize that the cost of capital has risen significantly over the past 18 months and variables such as loan-to-value, debt service coverage ratios and NOI debt yields have tightened considerably. That said, there is still a significant amount of capital available. There is a plethora of dry powder on the sidelines, several office properties have successfully refinanced mortgages and CMBS origination activity is picking up. Further, public REITs have raised more than USD 100 billion, largely in the unsecured debt markets, over the past two years. In addition, lending standards for CRE loans are beginning to loosen up, with demand for CRE loans picking up as well.

Bank Exposure: Understanding CRE debt exposure, at the bank level is crucial. Segmenting bank CRE loan exposure by asset size paints a clearer picture of potential risks to the banking system. Banks hold slightly over 50% of the total outstanding CRE loan, with smaller banks, particularly those with assets under USD 20 billion, account for a significant portion (28.3%). While larger banks having relatively small exposure (11%). The estimated bank CRE exposure to the office sector is between 2%-4%. Given this segmentation the overall risk of a CRE crisis seems relatively low.

Although this reinforces our view that there is an increased risk of defaults at smaller banks; given the large pool of dry powder, opening of capital markets, combined with willingness of larger banks with federal institutions to purchase select CRE loan portfolios, we do not believe a GFC-style banking crisis is a high probability.

Main contributor: Shawn Awan, Research and Communications Associate

For more information on this, see: Quarterly private markets update