GAO U.S. Government Accountability Office

# COMMERCIAL REAL ESTATE: Trends, Risks, and Federal Monitoring Efforts

GAO-24-107282
Q&A Report to Congressional Committees
September 24, 2024

## Why This Matters

The amount of outstanding commercial real estate (CRE) loans held by banks doubled from about $1.4 trillion to about $3 trillion from January 2012 through January 2024. CRE loans are generally used to acquire, develop, construct, improve, or refinance real property, such as office, multifamily, or retail properties. However, recent declines in performance of certain CRE loans have raised questions among regulators and industry observers about potential negative effects on the broader financial system. In March 2024, New York Community Bancorp required a $1 billion cash infusion to help it survive large losses from its CRE portfolio. Banks with high CRE concentrations may be more vulnerable to failure if their loan performance weakens.

The federal prudential banking regulators help ensure that banks are operating in a safe and sound manner, including by monitoring the banks' management of CRE concentrations. These regulators are the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency (OCC). We have ongoing work on the regulators' communication and escalation of supervisory concerns, which could include concerns related to CRE concentration levels.

The shift to remote and hybrid work during the COVID-19 pandemic and rising interest rates have intensified concerns about banks' exposure to CRE. The CARES Act includes a provision for GAO to monitor and oversee federal efforts to address the COVID-19 pandemic. This report examines trends in the CRE market, the pandemic's impact on these trends, banks' exposure to CRE concentrations, and federal monitoring efforts related to CRE loans.

## Key Takeaways

- The CRE market has experienced strains from the pandemic-related rise in remote and hybrid work, rising interest rates, and declining prices since 2022, particularly for office properties. These trends have made it harder for some property owners to repay their loans.
- CRE loan delinquency rates have increased steadily since 2022 but remain lower than during the 2007–2009 financial crisis.
- Banks have generally responded to the risks of potential CRE losses by working with borrowers to modify loans and reduce delinquencies and defaults. Many lenders have also reported tightening their lending standards for CRE loans.
- Banking regulators monitor CRE lending and apply enhanced scrutiny to banks with high CRE concentrations. CRE has been designated as an area of supervisory focus, with regulators noting its potential risks to the broader financial system. While currently deemed manageable, recent events, such as significant losses experienced by New York Community Bancorp, highlight the potential for systemic risk associated with CRE exposure.

## What are the types of CRE properties?

CRE is primarily composed of office, multifamily, retail, lodging, and industrial sectors.

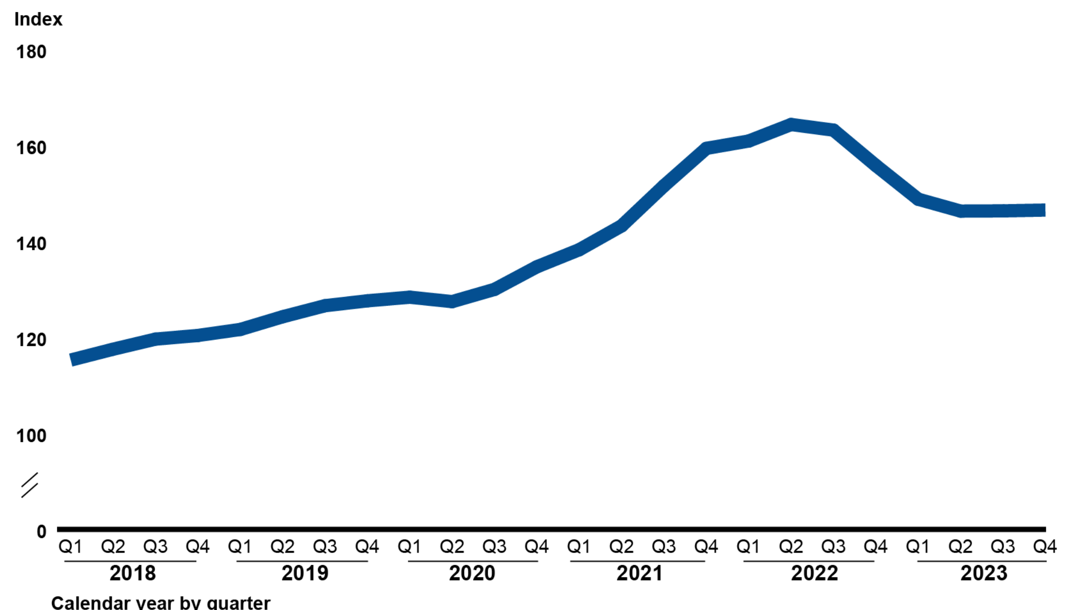
- **Office:** General-use, leasable properties primarily designed for business operations
- **Multifamily:** Residential properties with five or more dwelling units, such as apartment buildings
- **Retail:** Shopping centers, malls, and single-tenant retailers
- **Lodging:** Economy, luxury, and extended-stay hotels
- **Industrial**: Warehouses, manufacturing facilities, and data centers, which are usually outside major metropolitan centers

## How have CRE prices and capitalization rates changed since 2018?

Two key indicators of CRE trends—prices and capitalization rates—suggest that credit and other risks associated with CRE lending have increased since 2018.

**Prices.** Between February 2018 and August 2022, CRE prices increased by about 44 percent, according to Real Capital Analytics (RCA) Commercial Property Price Indexes data (see fig. 1).[1] However, prices then declined about 11 percent from August 2022 through December 2023 (the most recent data available). CRE prices experienced the largest year-to-year decrease between October 2022 and October 2023 since the end of 2009, according to International Monetary Fund data.[2] From August 2022 through January 2024, prices dropped for all property types except industrial properties, primarily driven by the pandemic-spurred shift to remote work and a rapid increase in interest rates. Office properties in central business districts, which have been disproportionately affected by remote work, saw the largest declines. In September 2023, prices of properties outside central business districts surpassed those within them. In general, declining property prices have resulted in rising bank losses from CRE loans.

**Figure 1: Real Capital Analytics Commercial Property Price Index, 2018–2023**

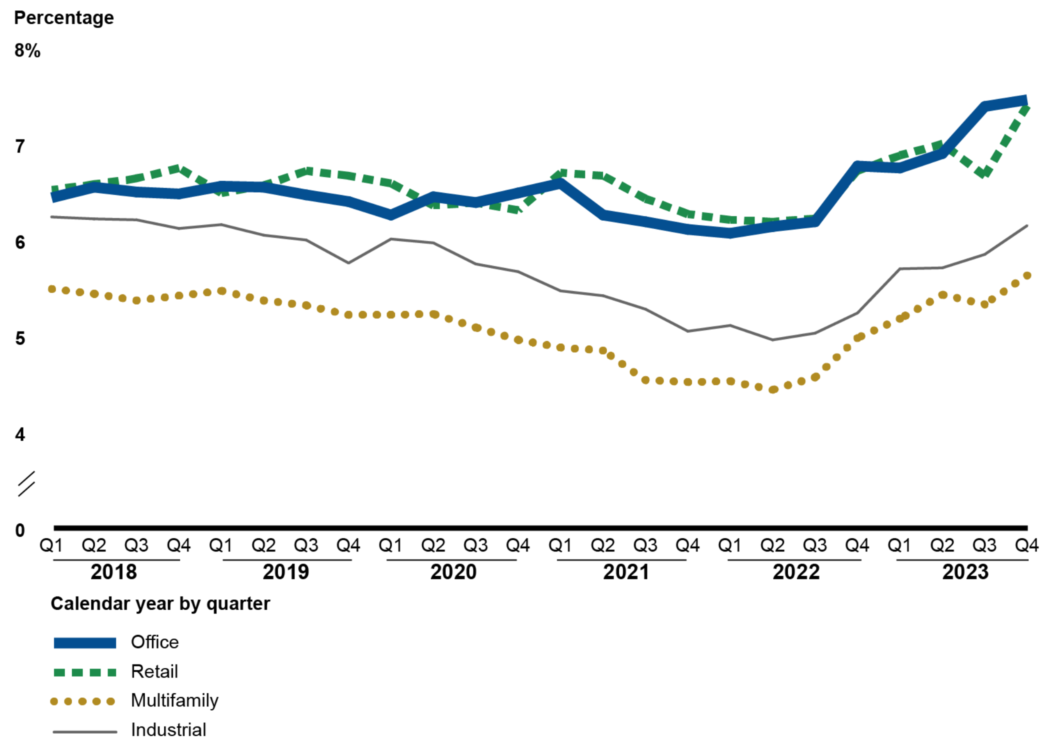



Source: GAO analysis of Bloomberg data. | GAO-24-107282

Note: Prices are based on the Real Capital Analytics Commercial Property Price Indexes, which measure the actual price movements for commercial properties based on transaction data. The indexes are based on repeat-sales transactions that occurred at any time through the month of the current report. The indexes are estimated using transaction data collected through the reported month to the date of production. December 2006 = 100.

**Capitalization rates.** CRE capitalization rates were generally stable between 2018 and 2021 but have risen since 2022 (see fig. 2). Capitalization rates represent the ratio of a property's net operating income to its market value. Properties with higher rates for the area typically produce larger monthly cash flows but tend to appreciate less over time. Higher rates also reflect higher potential risks for investors and banks, and may be elevated because the property is in an undesirable area (which lowers property values) or a sector with a historically high default rate. From January 2018 through December 2023, the office and retail sectors had the highest capitalization rates, whereas multifamily had the lowest.

**Figure 2: Capitalization Rates for Commercial Real Estate Properties, by Sector, 2018–2023**




Source: GAO analysis of Bloomberg data. | GAO-24-107282

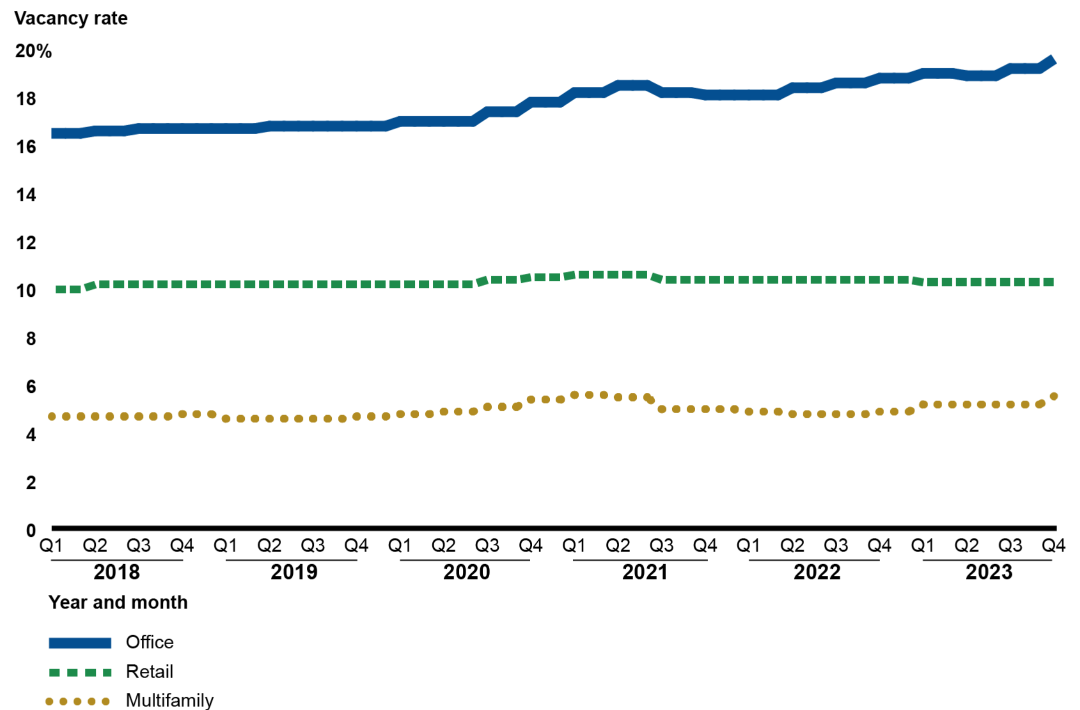
Note: Capitalization rates were not available in Bloomberg for the lodging sector as of January 2024.

## How has remote and hybrid work affected the office sector?

Office buildings have experienced higher vacancy rates than other forms of commercial properties since at least 2007, and the increase in remote and hybrid work since 2020 has pushed those rates even higher.

According to Bloomberg data, office properties have had higher vacancy rates than multifamily or retail properties since 2007, and the gap has widened since 2018.[3] The vacancy rates for all properties were relatively stable from 2012 through the end of 2019. But beginning in the second quarter of 2020, the vacancy rate for all property types increased, with office properties experiencing the largest increases through 2023 (see fig. 3). It is likely that the published office vacancy rates underrepresent the amount of vacant office space, as space that is leased but not fully used may turn into vacancies once those leases come up for renewal.

**Figure 3: Vacancy Rates for Office, Retail, and Multifamily Properties, 2018–2023**




Source: GAO analysis of Bloomberg data. | GAO-24-107282

Note: Vacancy rates were calculated by Moody's Analytics REIS and accessed through Bloomberg.

The COVID-19 pandemic contributed to this widening gap. From April 2020 through September 2021, the amount of commercial office space vacated or newly constructed surpassed the amount newly leased by tenants. This marked the first "negative net absorption" since 2012, and it generally persisted through at least the end of 2023.

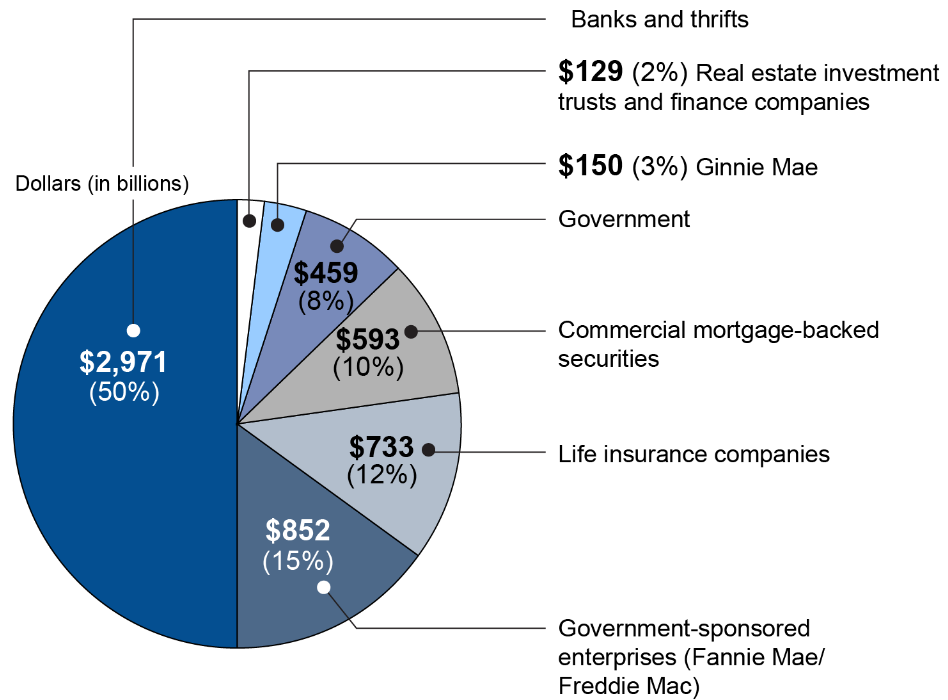
Office utilization, although rising, remains below pre-pandemic levels. One indicator found that in-office use averaged about 48 percent of pre-pandemic levels across 10 metropolitan cities as of April 2024.[4] According to Moody's, 13 of the 25 largest U.S. office markets had a decrease in actual rent paid for office properties between the fourth quarters of 2019 and 2023, reflecting the impact of remote work.[5]

While the office sector as a whole has faced stress, certain types of office properties have performed well. For example, medical offices, which generally have lower levels of remote work, have demonstrated stable performance. Similarly, buildings that offer attractive locations and amenities have maintained high demand.

## Who holds CRE loans?

About half of outstanding CRE loans are held by banks. According to Federal Reserve data, as of October 2023 (the most recent data we obtained), about $3 trillion of the $5.9 trillion in outstanding CRE loans was held by banks. The remaining loans were held by certain government-sponsored enterprises (Fannie Mae and Freddie Mac), life insurance companies, commercial mortgage-backed securities, government entities, Ginnie Mae, and real estate investment trusts and finance companies (see fig. 4).[6]

**Figure 4: Outstanding Commercial Real Estate Debt by Source, as of October 2023**




Source: Board of Governors of the Federal Reserve System. | GAO-24-107282

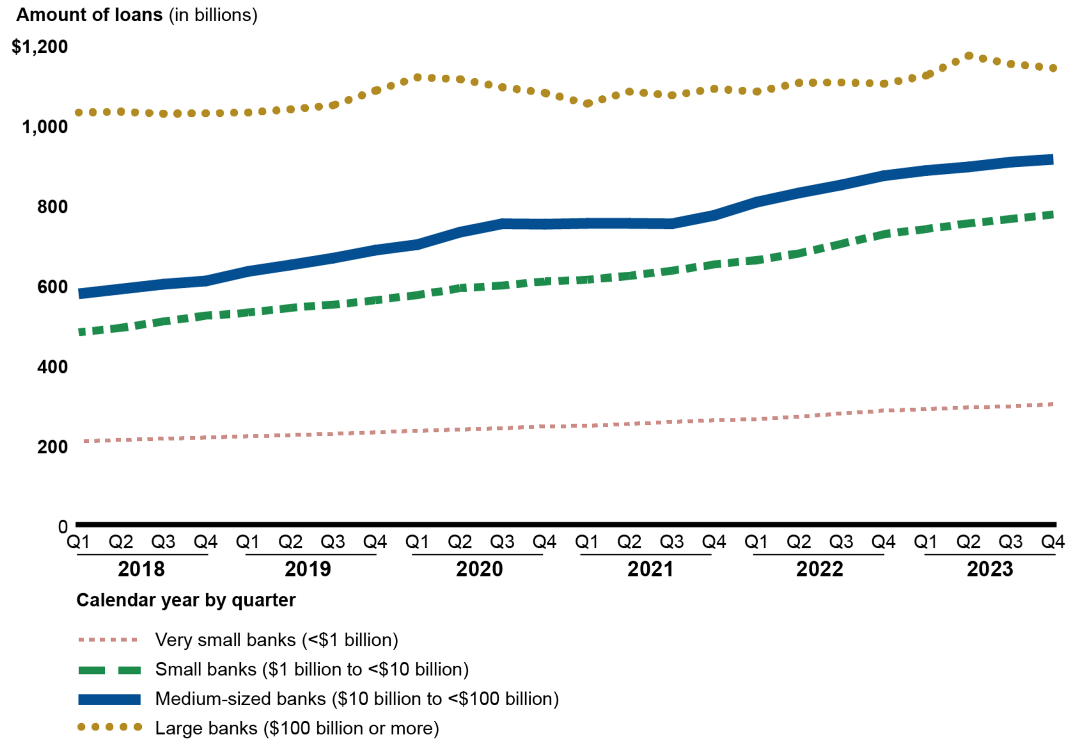
Note: GAO summary of CRE Finance Council analysis of Federal Reserve data.

## How has bank CRE lending changed since 2018?

Banks have generally increased their CRE loan holdings since 2018, and loan size, demand, and exposure have varied by bank size.

**Banks' loan holdings.** Since 2018, the total amount of CRE loans has increased for banks of all sizes, but the largest banks had more fluctuations in growth compared to other banks. Our analysis of bank financial statement filings found that very small (less than $1 billion in assets), small ($1 billion to less than $10 billion in assets), and medium-sized banks ($10 billion to less than $100 billion in assets) generally increased their CRE loan holdings each quarter from 2018 through the end of 2023.[7] In contrast, the total value of CRE loans held by large banks (at least $100 billion in assets) fluctuated more quarter-to-quarter during that period (see fig. 5).[8]

**Figure 5: Commercial Real Estate Loans Held by Banks (Adjusted for Inflation to 2023 Dollars), by Bank Asset Size, 2018–2023**



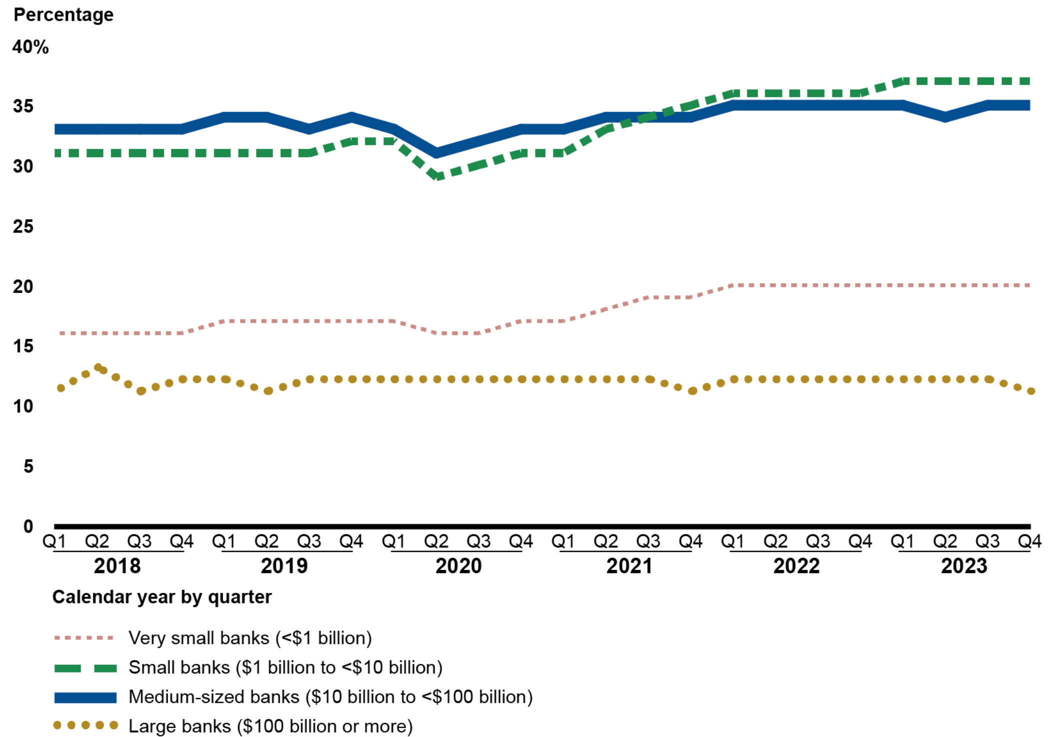

Source: GAO analysis of Federal Financial Institutions Examination Council data. | GAO-24-107282

**Median loan amount held by banks.** The median amount of CRE loans held by banks increased with bank size. For example, the median amount of CRE loans held by medium-sized banks at the end of 2023 (about $6.2 billion) was about nine times larger than the median size held by small banks ($682 million).[9]

**Loan demand.** Demand for new CRE loans generally decreased from 2018 through 2023. Banks reported decreased demand for CRE loans in more than two-thirds of the quarters during that period, according to a Federal Reserve survey of bank senior loan officers.[10] Despite this, the total amount of outstanding CRE loans increased almost every week since January 2018, according to Federal Reserve data. The increase was due in part to banks extending the terms of many expiring loans.

**CRE loan exposure.** The share of CRE loans in banks' portfolios increased from 2018 through 2023 (see fig. 6). Our analysis found that the median CRE loan proportions for very small, small, and medium-sized banks increased by about 4, 6, and 2 percentage points, respectively, during that period. In contrast, large banks increased their median CRE loan proportions by about 0.1 percentage point. According to credit rating agency officials, banks with more assets usually have more diversified revenue streams and are less reliant on CRE loans than smaller banks.

**Figure 6: Median Bank-Level Percentage of Commercial Real Estate Loans to Total Loans and Leases, by Bank Asset Size, 2018–2023**

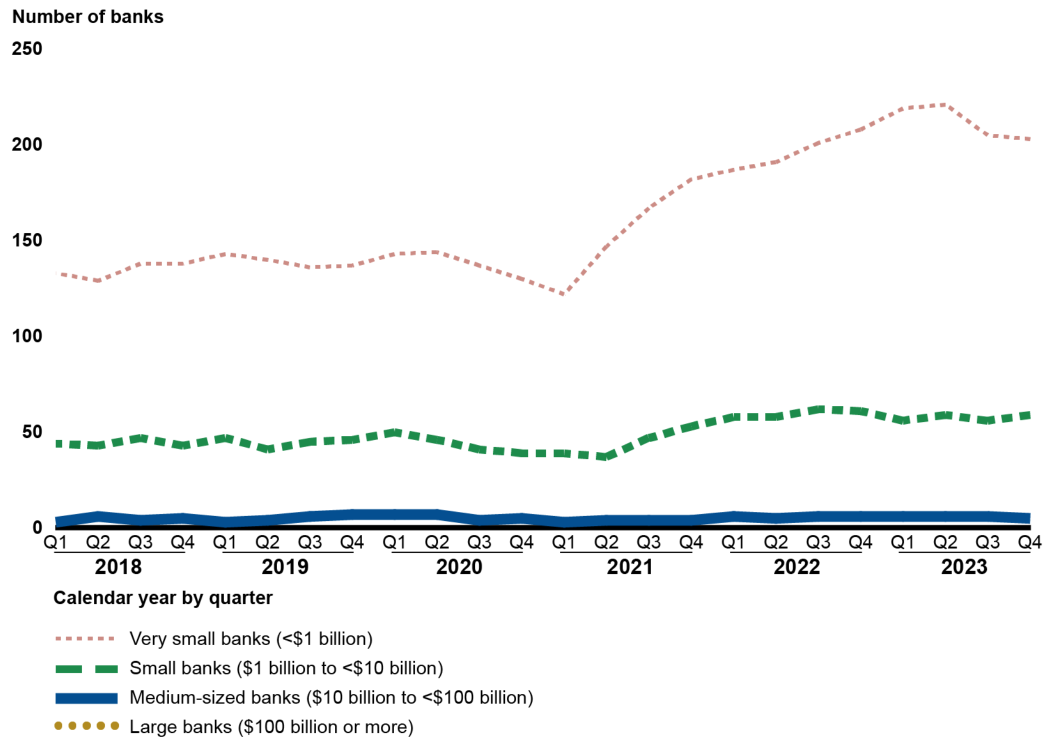



Source: GAO analysis of Federal Financial Institutions Examination Council data. | GAO-24-107282

The percentage of CRE loans banks hold relative to the value of their total loan holdings varies by bank size. Our analysis shows that from 2018 through 2023, CRE loans accounted for at least 23 percent of the total value of loans each year for very small, small, and medium-sized banks, but less than about 13 percent for large banks. Additionally, the proportion of the value of CRE loans to total loans increased by about 5 percentage points for very small, small, and medium-sized banks since 2018.

Further, more very small banks have higher concentrations of CRE loans than larger banks. For example, we found that at least 130 very small banks held construction, land development, and other land loans exceeding 100 percent of their total capital (the threshold regulators use to identify banks with high CRE concentrations) in all but three of the 24 quarters from 2018 through 2023. In contrast, fewer than 12 medium-sized banks and no large banks exceeded this threshold each quarter (see fig. 7).

**Figure 7: Banks with Construction and Land Development Loans Exceeding 100 Percent of Total Capital, by Bank Asset Size, 2018–2023**




Source: GAO analysis of Federal Financial Institutions Examination Council data. | GAO-24-107282

Note: No large banks exceeded the 100 percent total capital threshold from 2018 through 2023.

## How can CRE loans pose risks to banks?

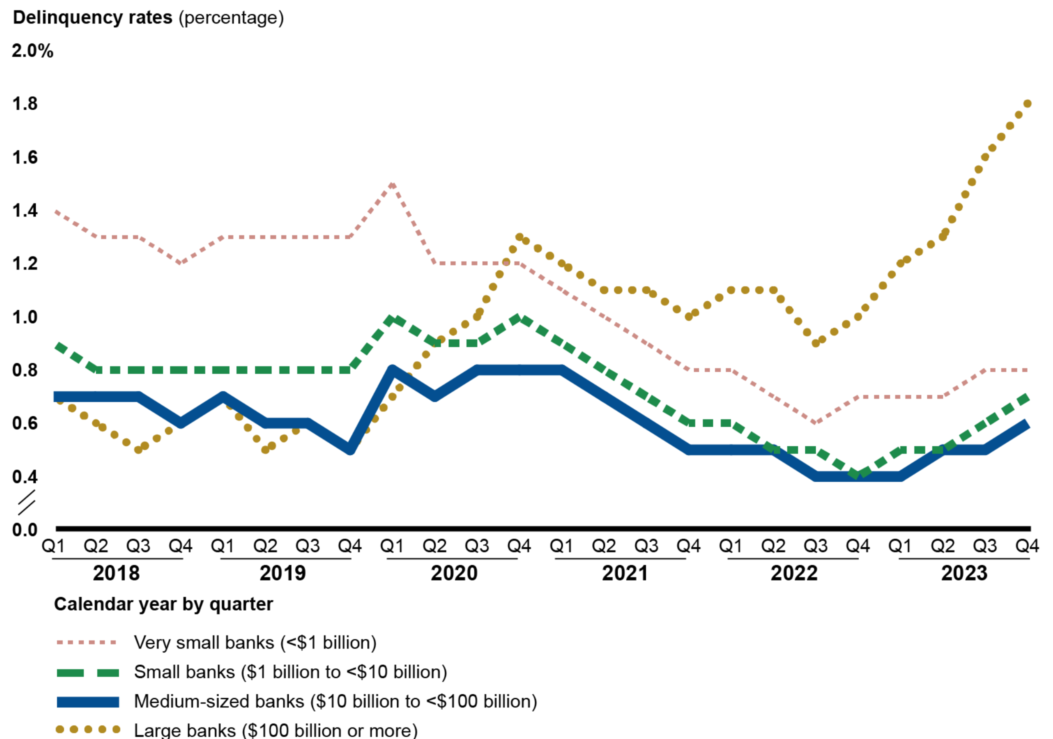
CRE loans can pose risks to banks when borrowers have difficulties making loan payments or default on their loans, especially for banks with large concentrations of CRE loans. Borrowers may struggle to repay their CRE loans due to inflation and rising vacancy rates, which can increase operating costs and decrease revenues. In addition, CRE loans typically have shorter maturities and balloon payments, and borrowers usually refinance their loans at maturity instead of repaying the outstanding balance. High interest rates and declining real estate prices can make it difficult for borrowers to refinance, as they may be unable to meet their bank's debt servicing requirements.[11] This increases the likelihood of loan default.

If not properly managed, potential losses from CRE loan defaults can increase the risk of bank failure. CRE lending concentrations, combined with weak risk-management practices, have contributed to past bank failures. For example, CRE loan losses have been identified as contributing to bank failures during the 2007–2009 financial crisis. More recently, New York Community Bancorp suffered significant losses in its CRE portfolio, particularly within its office and multifamily loans. As a result, in March 2024, the bank received a $1 billion cash infusion from investors to help bolster its capital levels and keep the bank afloat.

Looking ahead, Trepp, an industry data firm, projects that about 20 percent (about $1.2 trillion out of $5.9 trillion) of the outstanding CRE loans will mature in 2024 and 2025, of which more than half are held by banks.[12] The large scale of maturing loans and related potential defaults can create stress on banks, particularly for those with high CRE loan concentrations.

The percentage of the total value of CRE loans that are delinquent (at least 30 days past due) has rapidly increased since the third quarter of 2022 for loans at large banks, while other banks have seen more modest increases (see fig. 8).

**Figure 8: Percentage of the Total Value of Commercial Real Estate Loans That Are Delinquent, by Bank Asset Size, 2018–2023**




Source: GAO analysis of Federal Financial Institutions Examination Council data. | GAO-24-107282

The delinquency rate for CRE loans increased every quarter from July 2022 through December 2023, according to Federal Reserve data. The delinquency rate peaked in December 2023 at about 1.2 percent, the highest rate since March 2015. In contrast, during and immediately after the 2007–2009 financial crisis, the delinquency rate was at least 2.5 percent, peaking at about 9 percent at the end of 2009. According to FDIC officials, CRE loans held by banks with $100 billion or more in assets generally accounted for the recent increase in delinquencies.

Banks also face some exposure to CRE risk through their investments in commercial mortgage-backed securities. Issuance of these securities has generally declined in recent years—from about $110 billion in 2021 to about $39 billion in 2023, according to Mortgage Bankers Association data.[13] At the same time, FDIC reported that the delinquency rate for the loans underlying these securities has risen, reaching 4.7 percent in February 2024.[14] While loans for multifamily, lodging, retail, and industrial properties experienced some increases in delinquency rates between February 2023 and February 2024, the office sector accounted for much of the total increase during that period, according to Trepp data.[15] The loan delinquency rate of office properties increased from about 2.4 percent in February 2023 to about 6.6 percent in February 2024, surpassing retail properties to become the sector with the highest delinquency rate.

## How are banks managing risks posed by CRE loans?

Banks are managing CRE loan risks by modifying loans and tightening underwriting standards.

**Loan modifications.** In general, banks have increasingly modified their CRE loans to manage risks and potential losses by extending loan terms or reducing interest rates. According to one study, the frequency of CRE loan modifications

rose from about 1.5 percent per quarter in late 2019 to about 17 percent by the end of 2020.[16] According to analysis reported by Trepp, this trend has continued more recently, as the amount of newly modified securitized loans increased from less than $500 million to about $2.5 billion between the first quarters of 2022 and 2024.[17] As previously discussed, CRE loans typically have shorter maturities and balloon payments.[18] Therefore, with extended loan terms, borrowers can continue repaying their loans at their existing, lower interest rate until the balloon payment comes due or the loan is subsequently refinanced.

**Tighter underwriting standards.** More lenders reported tightening underwriting standards from July 2022 through December 2023, based on the Federal Reserve's quarterly survey of bank senior loan officers.[19] For example, from October 2022 through December 2023, 40 percent or more of surveyed lenders reported having tightened underwriting standards for CRE loans (1) with construction and land development purposes, (2) of multifamily residential structures, or (3) of nonfarm, nonresidential structures. This suggests that banks are becoming more cautious and reevaluating the extent to which they can take on new exposure in CRE markets.

## How do banking regulators monitor CRE lending through supervision?

Banking regulators (FDIC, the Federal Reserve, and OCC) monitor CRE lending through their supervision of banks, using on-site examinations and off-site monitoring.[20]

Banking supervision is intended to help ensure banks operate in a safe and sound manner and comply with applicable federal banking laws and regulations. To oversee banks and bank holding companies, banking regulators conduct examination activities that target specific functional areas or business lines, including CRE lending. Regulators also use off-site monitoring to monitor the financial condition of individual banks and the banking system.[21] In addition, the regulators monitor the banking sector and broader financial stability through stress tests that evaluate whether certain large banks and holding companies have sufficient capital to remain financially sound under economic stress.

In December 2006, the regulators jointly issued guidance on CRE concentrations and sound risk-management practices, describing their expectations for banks with concentrations in CRE loans. The guidance identified internal control areas to identify, monitor, and manage CRE concentration risk. It established the following three criteria for identifying banks that could be subject to greater supervisory scrutiny:

1. Rapid growth in CRE lending
2. Notable exposure to a specific type of CRE
3. Approaching or exceeding the following supervisory criteria: (a) total reported loans for construction, land development, and other land representing 100 percent of more of the bank's total capital; or (b) total CRE loans represent 300 percent or more of the bank's total capital, and the outstanding balance of the bank's CRE loan portfolio has increased by 50 percent of more during the prior 36 months[22]

In 2018, we found that the risk-management framework of the regulators' 2006 CRE guidance was adequately designed to help ensure that banks effectively identify, measure, monitor, and manage their CRE concentration risk. We also found that the framework was consistent with credit and concentration risk principles issued by international standard-setting bodies and with internal control standards.[23]

In 2023, the banking regulators updated their guidance on managing CRE portfolios in all business cycles, particularly during challenging economic

environments. The updated guidance established risk-management practices for short-term accommodations and encouraged financial institutions to work proactively and prudently with borrowers who may struggle to repay loans during periods of financial stress. We compared these updates made since 2018 against relevant federal internal control standards for risk assessment and found that the updated guidance was generally consistent with these standards.[24]

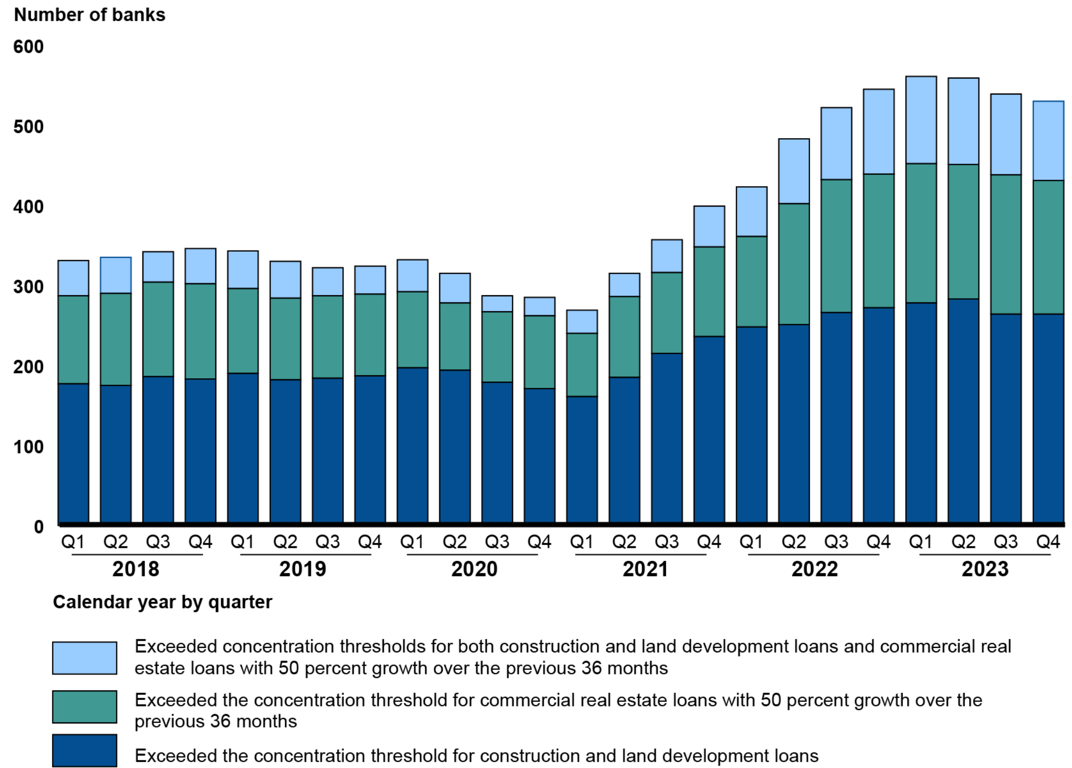
## What additional steps do regulators take for banks with high CRE concentrations?

Banks with relatively high CRE concentrations, as identified by criteria described above, may receive enhanced monitoring from regulators. This includes regulators analyzing potential risks and the banks' practices for managing the risks. Examiners may also increase supervisory monitoring for banks that have not exceeded the CRE concentration thresholds if other risk factors are present, such as rapidly growing CRE loan portfolios or market risks.

According to the regulators, between 2018 and 2023, the number of banks with high CRE concentrations (those exceeding the thresholds) that received enhanced monitoring ranged from 335 to 437 banks annually. Of these years, 2023 saw the largest number of banks receive enhanced monitoring. FDIC officials noted that the agency temporarily heightened its monitoring of CRE exposures at FDIC-supervised community banks in 2023. The Federal Reserve also intensified supervisory efforts to assess banks' preparedness for managing credit risks, including for CRE-concentrated state member banks, according to an agency report. Federal Reserve officials stated that the regulator implemented these efforts beginning in August 2022

In general, the number of banks exceeding the regulatory concentration thresholds gradually increased each quarter from 2021 through the first quarter of 2023, but then slightly decreased during the last three quarters of 2023. Overall, about 530 banks exceeded the regulatory concentration thresholds as of December 31, 2023 (see fig. 9).

Figure 9: Banks with Concentrations in Construction and Land Development and Commercial Real Estate Loans, 2018–2023




Source: GAO analysis of Federal Financial Institutions Examination Council data. | GAO-24-107282

Note: We define commercial real estate (CRE) concentrations as construction and land development loans representing 100 percent or more of a bank's total capital or CRE nonowner-occupied loans representing 300 percent or more of a bank's total capital and with 50 percent growth over the previous 36 months.

## What concerns have regulators and credit rating agencies raised?

FDIC, the Federal Reserve, OCC, and credit rating agencies have expressed concerns about the CRE market's potential impact on the financial system. The regulators have identified CRE as a risk to banks and the financial system, citing potential declines in property valuations that could lead to significant losses for banks with concentrated CRE exposures. Additionally, they noted that refinancing CRE loans remained a challenge for both borrowers and the banking industry due to high interest rates, softening property values, and emerging credit weaknesses.[25]

FDIC, the Federal Reserve, and OCC also identified weaknesses in risk-management practices for some banking institutions. The Federal Reserve's 2024 *Supervision and Regulation* report stated that, as of December 2023, about two-thirds of large financial institutions (those with assets of $100 billion or more) did not receive satisfactory ratings across all of the regulator's rating components.[26] The report noted an increase in supervisory findings related to weaknesses in liquidity and interest rate risk-management practices. According to the report, some large financial institutions have generally increased provisions for credit losses, including CRE loan losses.[27]

While the majority of community and regional banks had satisfactory ratings, there was an increase in rating downgrades due to weaknesses in interest rate and liquidity risk-management practices, according to the Federal Reserve report. Although some community and regional banks reported deteriorating CRE loan performance, their overall asset quality remained sound.

In 2023, FDIC reported that examiners observed weaknesses in some banks' risk-management practices, such as missing loan-level data, unsupported projections when assessing repayment capacity, and risk rating frameworks that generally lacked objective financial metrics or criteria.[28] FDIC also stated that banks substantively involved in CRE lending weathered the pandemic better when they had robust contingency planning and stress testing processes in place.

Credit rating agencies have reported that CRE credit quality is beginning to decline among certain lenders and property types. For example, Fitch reported in December 2023 that the ratio of nonperforming CRE loans to total loans had increased for nine consecutive quarters among banks with total assets over $250 billion.[29] Larger banks have more exposure to central business district properties, which have experienced more pricing pressures and a higher risk of default. In contrast, smaller banks have generally maintained stable or improved CRE loan performance but remain exposed to significant losses from their higher CRE concentrations, according to Fitch.

## To what extent have regulators and others reported that CRE risks affect financial stability?

Trends in the CRE market pose risks to financial stability, but these risks appear to be manageable for most banks, according to banking regulators. For example, the Federal Reserve has cautioned that weakness in economic activity could compound existing CRE market strain and amplify financial system risks.[30]

Banking regulators and others remain cautious, emphasizing the importance of closely monitoring CRE risks due to their contribution to past bank failures, such as the failures of small and medium-sized banks following the 2007–2009 financial crisis.[31] A July 2024 Office of Financial Research analysis found that many banks with high CRE concentrations share similar financial conditions to banks that failed in 2023, such as large unrealized securities losses and high proportions of uninsured deposits.[32]

In December 2023, the Financial Stability Oversight Council recommended that regulators continue to closely monitor CRE exposures and market conditions.[33] Similarly, in January 2024, the International Monetary Fund noted that it will be important for U.S. banking regulators to conduct ongoing monitoring and management of CRE risks to mitigate the potential risks to financial stability. Banking regulator officials stated that they have heightened their supervisory monitoring of banks with high CRE concentrations and continue to analyze CRE market conditions.

To address concerns identified through supervisory monitoring, regulators may raise supervisory concerns to banks, which could lead to an enforcement action if identified improvements are not made. However, we have reported on long-standing concerns about the timeliness of such escalation. In 2023, we found that the Federal Reserve and FDIC did not escalate supervisory concerns in time to mitigate key risks that led to the failures of Silicon Valley Bank and Signature Bank, respectively, despite identifying weaknesses in the banks' liquidity and risk-management practices.[34]

In March 2024, we found that FDIC updated its procedures for escalating supervisory concerns. We also recommended that the Federal Reserve revise its procedures on when to escalate supervisory concerns to be clearer and more specific.[35] The Federal Reserve agreed with our recommendation but had not yet implemented it as of July 2024. We have ongoing work on the regulators' communication and escalation of supervisory concerns, which could include concerns related to CRE concentration levels.

FDIC, Federal Reserve, and OCC officials stated that banks are generally positioned to manage CRE risks and their potential threats to financial stability. The Federal Reserve's 2024 annual stress test showed that large banks could withstand a hypothetical severe global recession and heightened stress in commercial and residential real estate and corporate debt markets, with an average projected CRE loss rate of 8.8 percent.[36] Although community banks are not subject to the stress test and have higher CRE concentrations than large banks, FDIC reported in 2024 that community banks had lower aggregate CRE loan delinquency rates, suggesting that risks to financial stability are potentially manageable.[37]

Further, regulators have observed that the banking sector's profitability has remained stable in the higher interest-rate environment, with generally stabilized liquidity and favorable asset quality metrics. These factors may help banks maintain an adequate level of liquidity, meet financial commitments, and weather challenges posed by CRE loan risks.

While regulators have noted that CRE risks are currently manageable, economic weakness and CRE concentration could amplify financial system risks. The experience of New York Community Bancorp illustrates the significant losses possible from CRE exposure. Further, the March 2023 closures of Silicon Valley Bank and Signature Bank underscored systemic risks. As the Financial Stability Oversight Council and International Monetary Fund noted, it will be important for the regulators to monitor CRE risks and the implications for financial stability.

## Agency Comments

We provided a draft of this report to FDIC, the Federal Reserve, and OCC for review and comment. FDIC and the Federal Reserve provided technical comments, which we incorporated as appropriate. OCC did not have any comments on the report.

## How GAO Did This Study

To describe CRE market trends since 2018, we reviewed industry reports and articles on the CRE market. We also analyzed price index, vacancy rate, and office utilization information using data from the RCA Commercial Property Price Indexes, Moody's Analytics REIS, and the Kastle Workplace Occupancy Barometer, respectively. We accessed these data through the Bloomberg Terminal, a computer software system provided by the financial data vendor, Bloomberg L.P., which contains real-time financial market data. We used data from the Federal Reserve's *Senior Loan Officer Opinion Survey on Bank Lending Practices* from January 2018 through January 2024 (the most recent data available at the time of our analysis) to analyze relative demand for CRE loans.[38]

To describe changes since 2018 in U.S. banks' CRE exposure and the potential effects of these changes on credit availability, we reviewed industry reports and articles, and analyzed bank financial statement filings. We analyzed data from Consolidated Reports of Condition and Income (also known as call reports) for 2018 through 2023, the most recently available full year data at the time of our analysis, for all banks that filed a report and were active as of December 2023.[39] Using these data, we calculated banks' construction and land development and CRE concentrations during the period. Specifically, we used the concentration formulas in the regulators' CRE concentration guidance to calculate banks' non-owner occupied CRE concentrations and identify banks whose CRE concentrations exceeded the guidance's CRE concentration thresholds during the time frame.[40]

We categorized the banks according to their total assets as of the end of 2023. We defined banks with less than $1 billion in total assets as very small, between

$1 billion and less than $10 billion as small, between $10 billion and less than $100 billion as medium-sized, and at least $100 billion as large. We accessed the financial data through FactSet, a financial data vendor and interface that contains real-time financial market data. We adjusted the data for inflation to quarter four 2023 dollars using the Quarterly Chain-Weighted Gross Domestic Product Price Index.

We also analyzed quarterly Federal Reserve data on CRE delinquency rates and results from its *Senior Loan Officer Opinion Survey on Bank Lending Practices* to determine the extent to which banks have tightened underwriting standards for CRE loans. These CRE loans included those (1) with construction and land development purposes, (2) secured by multifamily residential structures, and (3) for nonfarm nonresidential structures.[41]

For the data we analyzed from the Bloomberg terminal, FactSet, and the Federal Reserve, we assessed the reliability of the data. This assessment included reviewing related documentation, interviewing data providers, and conducting electronic testing. We determined that these data were sufficiently reliable for describing trends in CRE and banks' concentrations of CRE loans.

To describe federal banking regulators' oversight of CRE lending activities, we reviewed and analyzed their relevant guidance and regulations on bank CRE lending, and examination policies and procedures. We also reviewed reports that FDIC, the Federal Reserve, OCC, and industry observers, such as credit rating agencies, have issued on risks to the financial sector. We analyzed the extent to which the guidance has changed since 2018.

We also determined that the risk assessment component of internal control was significant to this objective, along with the underlying principles that management should identify, analyze, and respond to risk related to achieving the defined objectives. We compared the 2023 guidance (the most recent at the time of our analysis) against federal internal control standards to determine the extent to which the updated guidance was consistent with the risk assessment component.[42] We also reviewed information from FDIC, the Federal Reserve, and OCC on their enhanced monitoring of banks with high CRE concentrations from 2018 through 2023.

To inform all our work, we also interviewed officials from the three financial regulators that supervise banks (the Federal Reserve, FDIC, and OCC) for their perspectives on the CRE market, risks to banks, and information on their monitoring efforts. We interviewed officials from the three largest credit rating agencies (Fitch Ratings, Moody's Analytics, and S&P Global Ratings) and Trepp, an industry participant that collects and analyzes CRE-related data, for their perspectives on the CRE market and risks to banks.

We conducted this performance audit from January 2024 to September 2024 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## List of Addressees

The Honorable Patty Murray
Chair
The Honorable Susan Collins

Vice Chair
Committee on Appropriations
United States Senate

The Honorable Ron Wyden
Chairman
The Honorable Mike Crapo
Ranking Member
Committee on Finance
United States Senate

The Honorable Bernard Sanders
Chair
The Honorable Bill Cassidy, M.D.
Ranking Member
Committee on Health, Education, Labor and Pensions
United States Senate

The Honorable Gary C. Peters
Chairman
The Honorable Rand Paul, M.D.
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Tom Cole
Chair
The Honorable Rosa L. DeLauro
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable Cathy McMorris Rodgers
Chair
The Honorable Frank Pallone, Jr.
Ranking Member
Committee on Energy and Commerce
House of Representatives

The Honorable Mark E. Green, M.D.
Chairman
The Honorable Bennie G. Thompson
Ranking Member
Committee on Homeland Security
House of Representatives

The Honorable James Comer
Chairman
The Honorable Jamie Raskin
Ranking Member
Committee on Oversight and Accountability
House of Representatives

The Honorable Jason Smith
Chairman
The Honorable Richard Neal

Ranking Member
Committee on Ways and Means
House of Representatives

We are sending copies of this report to the appropriate congressional committees, the Chairman of the Federal Deposit Insurance Corporation, Acting Comptroller of the Currency, Chair of the Board of Governors of the Federal Reserve System, and other interested parties.

## GAO Contact Information

For more information, contact: Michael Clements, Director, Financial Markets and Community Investment, ClementsM@gao.gov, 202-512-8678.

Sarah Kaczmarek, Managing Director, Public Affairs, KaczmarekS@gao.gov, (202) 512-4800.

A. Nicole Clowers, Managing Director, Congressional Relations, ClowersA@gao.gov, (202) 512-4400.

**Staff Acknowledgments:** Tarek Mahmassani (Assistant Director), Juliann Vadera (Analyst in Charge), Lauren Capitini, Garrett Hillyer, Risto Laboski, Jill Lacey, Daniel Newman, Jason Rodriguez Masi, Jena Sinkfield, and Brennan Williams.

Connect with GAO on Facebook, Flickr, Twitter, and YouTube. Subscribe to our RSS Feeds or Email Updates. Listen to our Podcasts.

Visit GAO on the web at https://www.gao.gov.

This is a work of the U.S. government but may include copyrighted material. For details, see https://www.gao.gov/copyright.

## Endnotes

[1]The RCA Commercial Property Price Indexes measure the actual price movements for commercial properties based on transaction data. The indexes are based on repeat-sales transactions that occurred at any time up through the month of the current report. They are estimated using transaction data collected through the reported month to the date of production.

[2]Overall CRE prices increased by about 28 percent between 2018 and 2024, according to RCA data. According to International Monetary Fund data, prices dropped about 7.5 percent between September 2022 and September 2023. In contrast, year-to-year prices decreased at least 23 percent from March 2009 through December 2009 following the 2007–2009 financial crisis, compared to the previous year. International Monetary Fund, Commercial Real Estate Prices for United States [COMREPUSQ159N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/COMREPUSQ159N, July 10, 2024.

[3]The vacancy rate is the percentage of all available units in a rental property, such as a hotel or apartment complex, that are vacant or unoccupied at a particular time. The vacancy rate is the opposite of the occupancy rate, which is the percentage of units in a rental property that are occupied.

[4]The Kastle Workplace Occupancy Barometer reflects swipes of Kastle access controls (used to enter a building) for commercial office buildings from 10 cities that have 300,000 of the 1.8 million total Kastle users globally. Data are reported weekly and compared to a 3-week daily credential use average in February 2020. The metropolitan areas included in the survey are Austin, TX; Chicago, IL; Dallas, TX; Houston, TX; Los Angeles, CA; New York, NY; Philadelphia, PA; San Francisco, CA; San Jose, CA; and Washington, DC. We accessed these data through the Bloomberg Terminal.

[5]According to Moody's data, San Francisco saw the largest decline in office rents, with a drop of almost 29 percent. This decline was partly driven by a 19-percentage-point increase in its vacancy rate, attributable to its high concentration of industries using hybrid work. Moody's Investor Service, *CMBS-US: Converting Pandemic-Hit Offices Will Likely Trim Loan Losses While Aiding Housing Supply* (New York, NY: Moody's Corporation, Mar. 5, 2024).

[6]A real estate investment trust generally owns income-producing real estate or real estate-related assets and may be publicly traded on a stock exchange. Commercial mortgage-backed securities are securities backed by mortgages for CRE, such as office buildings or shopping centers. Government CRE includes properties owned by state and local governments or special authorities, such as stadiums and hospitals.

[7]There were 3,647 banks with less than $1 billion in assets (very small), 836 with $1 billion to less than $10 billion in assets (small), 125 with $10 billion to less than $100 billion in assets (medium) and 33 banks with at least $100 billion in assets (large).

[8]We accessed the data through FactSet, a financial data vendor and interface that contains real-time financial market data.

[9]The median amount held by very small banks at the end of 2023 was about $44 million, by small banks about $682 million, by medium-sized banks about $6.227 billion, and by large banks about $19.919 billion.

[10]The Federal Reserve's *Senior Loan Officer Opinion Survey on Bank Lending Practices* surveys up to 80 large domestic banks and 24 U.S. branches and agencies of foreign banks. The Federal Reserve generally conducts the survey quarterly, timing it so that results are available for the January/February, April/May, August, and October/November meetings of the Federal Open Market Committee. Questions cover changes in the standards and terms of the banks' lending and the state of business and household demand for loans. The survey results are not generalizable to all domestic banks or to U.S. branches and agencies of foreign banks.

[11]Banks impose minimum debt-service coverage ratios and maximum loan-to-value requirements that borrowers must meet. Lower valuations for the property create to higher loan-to-value ratios, while diminished cash flows lead to reduced debt service coverage ratios.

[12]As of May 2024, Trepp projected that about $640 billion in total commercial loans would mature in 2024 and about $540 billion in 2025. Trepp, "CRE Mortgage Maturities & Debt Outstanding – Q4 2023 update" (New York, NY: May 8, 2024).

[13]Mortgage Bankers Association, *Commercial/ Multifamily Quarterly Databook: Q1 2024* (Washington, D.C.: Mortgage Bankers Association, June 28, 2024).

[14]While delinquency rates for commercial mortgage-backed securities have been increasing recently, Federal Reserve officials stated that banks typically hold agency commercial mortgage-backed securities (those issued by a U.S. agency or federally chartered corporation) and that such securities usually have the lowest risk of default. FDIC, *Risk Review: 2024* (Washington, D.C.: May. 22, 2024).

[15]Trepp, "CMBS Delinquency Rate Inches Up in February, Driven by Office Sector" (New York, NY: Mar. 1, 2024).

[16]David Glancy, Robert J. Kurtzman, and Lara Loewenstein, "Loan Modifications and the Commercial Real Estate Market," *Finance and Economics Discussion Series,* 2022-050, (Washington, D.C.: July 26, 2022).

[17]The modification volume peaked during the third quarter of 2023 at $3.9 billion. Trepp, "A Deep Dive into CMBS Loan Modification Trends" (New York, NY: May 2024).

[18]A borrower may be able to refinance its CRE loan before the balloon payment comes due. A borrower may hesitate to refinance the loan, however, if the interest rate offered by the bank is higher than its current interest rate on the balloon loan. In these or other cases, a bank may offer the borrower a loan extension, which extends the term of the loan, delaying the balloon payment and allowing the borrower to continue paying at their current interest rate.

[19]Underwriting standards include factors such as the capacity of the borrower or income from the underlying property to adequately service the debt; the market value of the underlying real estate collateral; the overall creditworthiness of the borrower; and the level of the borrower's equity invested in the property. We report results from the Federal Reserve's *Senior Loan Officer Opinion Survey*, which summarizes changes in underwriting by the "net percentage" of banks tightening underwriting standards on various classes of loans. This refers to the percentage of banks that reported tightening standards minus the percentage of banks that reported loosening standards. A positive number indicates that more banks are tightening than loosening standards.

[20]The Federal Reserve supervises state-chartered banks that are members of the Federal Reserve System, and bank and savings and loan holding companies, among others. FDIC supervises insured state-chartered banks that are not members of the Federal Reserve System, as well as state-chartered savings associations and insured state-chartered branches of foreign banks. FDIC also administers the Deposit Insurance Fund, which insures the deposits of all banks and savings associations that are approved for federal deposit insurance. In this role, FDIC has supervisory authority over all banks and savings associations that are federally insured, as well as special examination authority over nonbank financial companies supervised by the Federal Reserve, or certain bank holding companies. OCC supervises federally chartered national banks and savings associations and federally chartered branches and agencies of foreign banks. The National Credit Union Administration supervises federally chartered credit unions and insures deposits in federally insured credit unions, which may include state-chartered credit unions, among others. We excluded credit unions from our report because they do not issue many CRE loans.

[21]For example, Federal Reserve officials noted that the regulator monitors CRE risk and trends by reviewing regulatory filings, examination reports and private sector data. Using this information, the Federal Reserve identifies individual banks that are outliers. For some banks, the Federal Reserve also meets regularly with bank management and reviews bank-provided risk reports.

[22]71 Fed. Reg. 74580 (Dec. 12, 2006). Capital generally is defined as a bank's long-term source of funding, contributed largely by the bank's equity stockholders and its own returns in the form of retained earnings. One important function of capital is to absorb losses. In March 2020, the prudential banking regulators issued an interagency statement to clarify the calculation of total capital (tier 1 capital plus allowance for credit losses attributed to loans and leases). OCC, Federal Reserve, and FDIC, *Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach* (Mar. 30, 2020).

[23]GAO, *Commercial Real Estate Lending: Banks Potentially Face Increased Risk; Regulators Generally Are Assessing Banks' Risk Management Practices*, GAO-18-245 (Washington, D.C.: Mar. 15, 2018).

[24]In July 2023, the banking regulators and the National Credit Union Administration updated and expanded their 2009 guidance on prudent CRE loan workouts. *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts*, 88 Fed. Reg. 43115 (July 6, 2023). In December 2023, FDIC issued an advisory on managing CRE concentrations in a challenging economic environment, noting that recent weaknesses in the current economic environment related to CRE sectors, including the office sector, had increased FDIC's overall concern for institutions with concentrations of CRE loans. The advisory reemphasized the importance of strong capital, appropriate credit loss allowance levels, and robust credit risk-management practices when managing CRE concentrations. FDIC, *Advisory: Managing Commercial Real Estate Concentrations in a Challenging Economic Environment* (Washington, D.C.: Dec. 18, 2023).

[25]Federal Reserve, *Financial Stability Report* (Washington, D.C.: Apr. 2024). FDIC, *Risk Review: 2024*. OCC, *Semiannual Risk Perspective from the National Risk Committee* (Washington, D.C.: June 18, 2024).

[26]Regulators assess the strength of banks using the Uniform Financial Institutions Rating System, also known as CAMELS. Bank examiners rate an institution on each CAMELS component (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk) and assign an aggregate rating to each bank based on the components.

[27]In May 2024 the Public Company Accounting Oversight Board published guidance on auditing considerations for CRE which encouraged auditors to monitor market developments and the potential for broader economic issues that could affect a wider group of public companies. The guidance included a list of example questions related to CRE for auditors to consider when planning and conducting the audit.

[28]FDIC, *Commercial Real Estate: An Update on Bank Lending Amid the Evolving Pandemic Backdrop* (Washington, D.C.: Mar. 2023).

[29]Fitch Ratings, *U.S. Bank Commercial Real Estate: Delinquencies Rising, Losses to Come* (New York, NY: Dec. 5, 2023).

[30]Federal Reserve, *Financial Stability Report* (Washington, D.C.: Apr. 2024).

[31]GAO, *Financial Institutions: Causes and Consequences of Recent Bank Failures*, GAO-13-71 (Washington. D.C.: Jan. 3, 2013).

[32]Office of Financial Research, *Bank Health and Future Commercial Real Estate Losses* (Washington, D.C.: July 11, 2024).

[33]Financial Stability Oversight Council, *Annual Report 2023* (Washington, D.C.: Dec. 14, 2023). The Dodd-Frank Wall Street Reform and Consumer Protection Act created the Financial Stability Oversight Council in 2010 to identify and respond to potential risks to the stability of the U.S. financial system.

[34]GAO, *Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures*, GAO-23-106736 (Washington. D.C.: Apr. 28, 2023).

[35]GAO, *Bank Supervision: More Timely Escalation of Supervisory Action Needed*, GAO-24-106974 (Washington, D.C.: Mar. 6, 2024).

[36]Federal Reserve, *2024 Federal Reserve Stress Test Results* (Washington, D.C.: 2024).

[37]FDIC, *Risk Review: 2024*.

[38]These CRE loans included those (1) with construction and land development purposes, (2) secured by multifamily residential structures, and (3) for nonfarm nonresidential structures. *Federal Reserve, Net Percentage of Domestic Banks Reporting Stronger Demand for Commercial Real Estate Loans with Construction and Land Development Purposes [SUBLPDRCDC],* retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCDC; *Net Percentage of Domestic Banks Reporting Stronger Demand for Commercial Real Estate Loans Secured by Multifamily Residential Structures [SUBLPDRCDM]*, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCDM; *Net Percentage of Domestic Banks Reporting Stronger Demand for Commercial Real Estate Loans Secured by Nonfarm Nonresidential Structures [SUBLPDRCDN],* retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCDN.

[39]We considered banks that filed a call report in December 2023 and reported more than “0” total assets to be active.

[40]The regulator guidance provides that the agencies will use three different criteria to identify banks that are potentially exposed to significant CRE concentration risk. One of those criteria, which we used for our calculations, establishes CRE concentration thresholds. Specifically, banks may be identified for enhanced monitoring if they are approaching or exceeding (1) total reported loans for construction, land development, and other land representing 100 percent or more of the bank’s total capital; or (2) total non-owner occupied CRE loans representing 300 percent or more of the bank’s total capital, and the outstanding balance of the bank’s CRE loan portfolio has increased by 50 percent of more during the prior 36 months. 71 Fed. Reg. 74580 (Dec. 12, 2006).

[41]Federal Reserve, *Delinquency Rate on Commercial Real Estate Loans (Excluding Farmland), Booked in Domestic Offices, All Commercial Banks [DRCRELEXFACBS]*, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DRCRELEXFACBS; *Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans with Construction and Land Development Purposes [SUBLPDRCSC]*, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCSC; *Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans Secured by Multifamily Residential Structures [SUBLPDRCSM]*, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCSM, *and Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans Secured by Nonfarm Nonresidential Structures [SUBLPDRCSN]*, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SUBLPDRCSN.

[42]GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: Sept. 10, 2014).