BankDirector

# Breakout 6:
# Outlook for U.S. Banks As Higher Rates Test The Mettle of CRE

**Nathan Stovall**
*S&P Global Market Intelligence*

#A0BA24

# Outlook for US Banks as Higher Rates Test the Mettle of CRE

**Nathan Stovall**
**Director, US Financial Institutions Research**
**Jan. 30, 2024**

S&P Global
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# Earnings growth challenging as banks prize liquidity, eye credit risk

- **Deposits remain in focus even as rates peak:** Banks continue to build liquidity, prize deposits amid deposit mix shift, regulatory scrutiny, leading to additional margin pressure.
- **Banks see higher credit losses:** Banks are building loan losses reserves amid higher rates, the end of COVID-19-era stimulus and post-pandemic changes in consumer behavior.
- **Banks face revenue headwinds:** Modest pressure on margins, higher credit costs push banks to focus on efficiency, possibly M&A.

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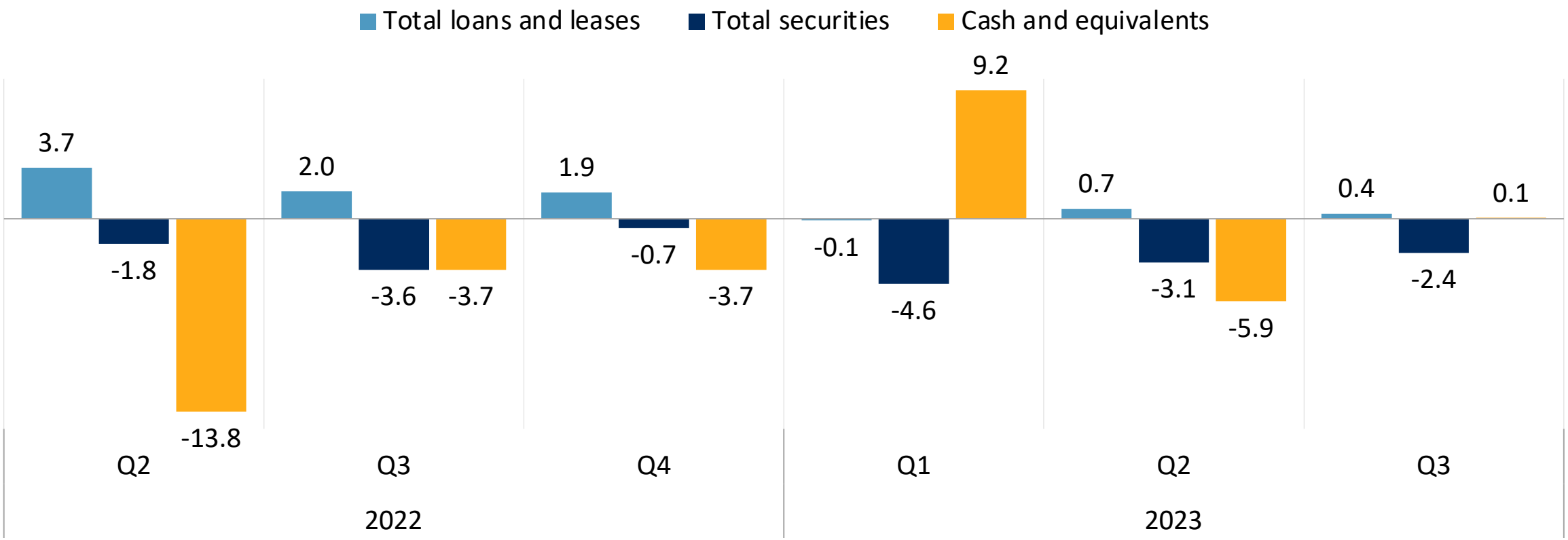
# US banks invest less in the bond market amid higher rates

## QOQ changes in US bank aggregate asset composition (%)




Data compiled Nov. 7, 2023.
Analysis includes US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.
Data based on regulatory filings as of Sept. 30, 2023.
Source: S&P Global Market Intelligence.

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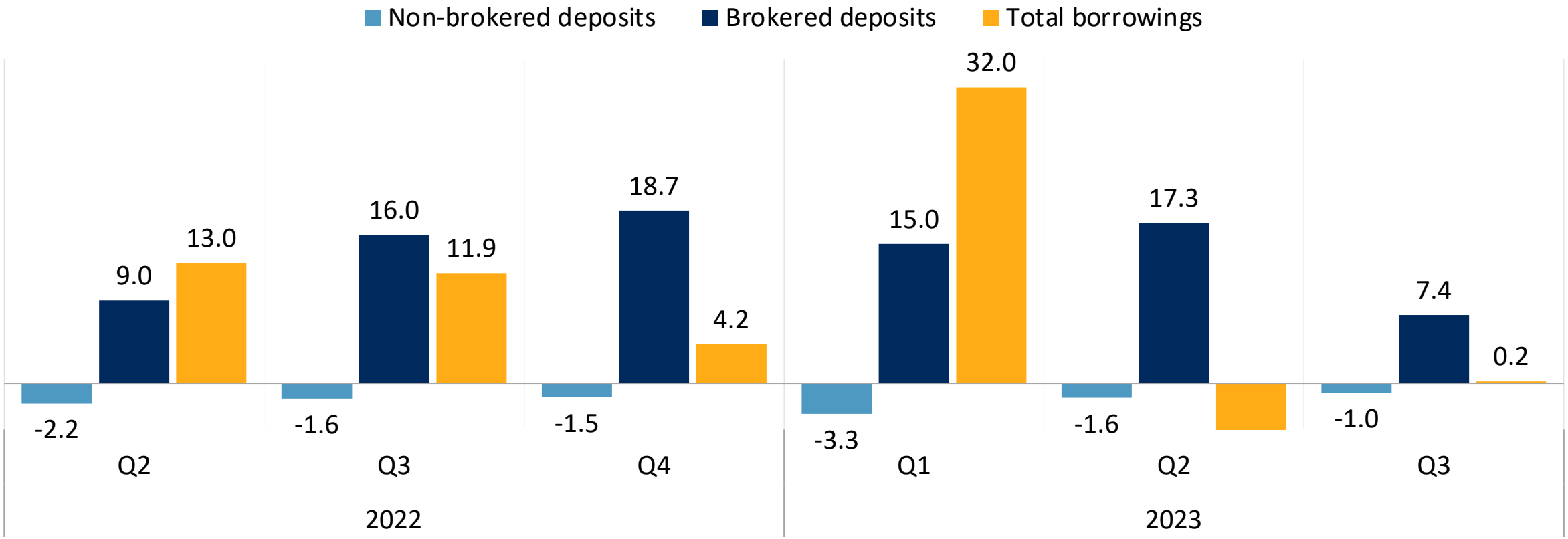
# US banks bolster their funding through higher-cost means

## QOQ changes in US bank aggregate funding composition (%)

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Analysis includes US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.
Data based on regulatory filings as of Sept. 30, 2023.
Source: S&P Global Market Intelligence.

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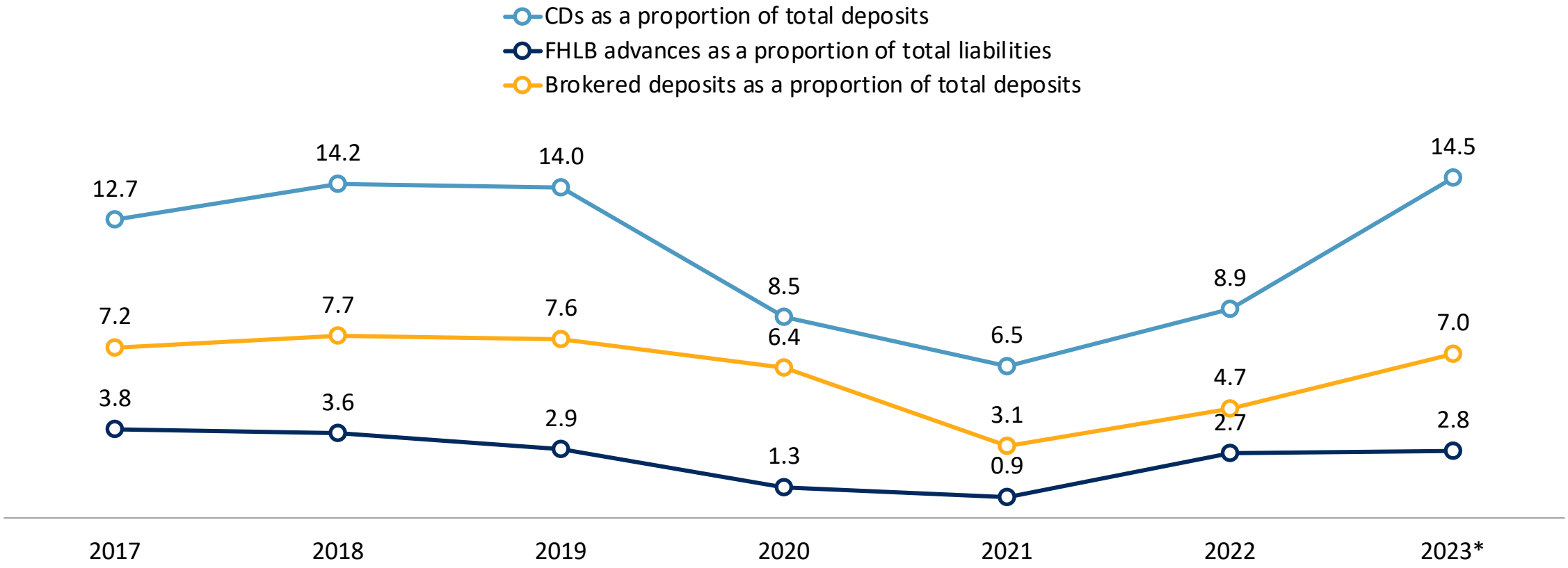
# Facing outflows, banks steadily grow term funding

## Term funding concentration for the US banking industry since 2017 (%)




Data compiled Dec. 18, 2023.
CD = certificate of deposit; FHLB = Federal Home Loan Bank.
Analysis includes US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.
* Data through Sept. 30, 2023.
Data based on regulatory filings.
Source: S&P Global Market Intelligence.

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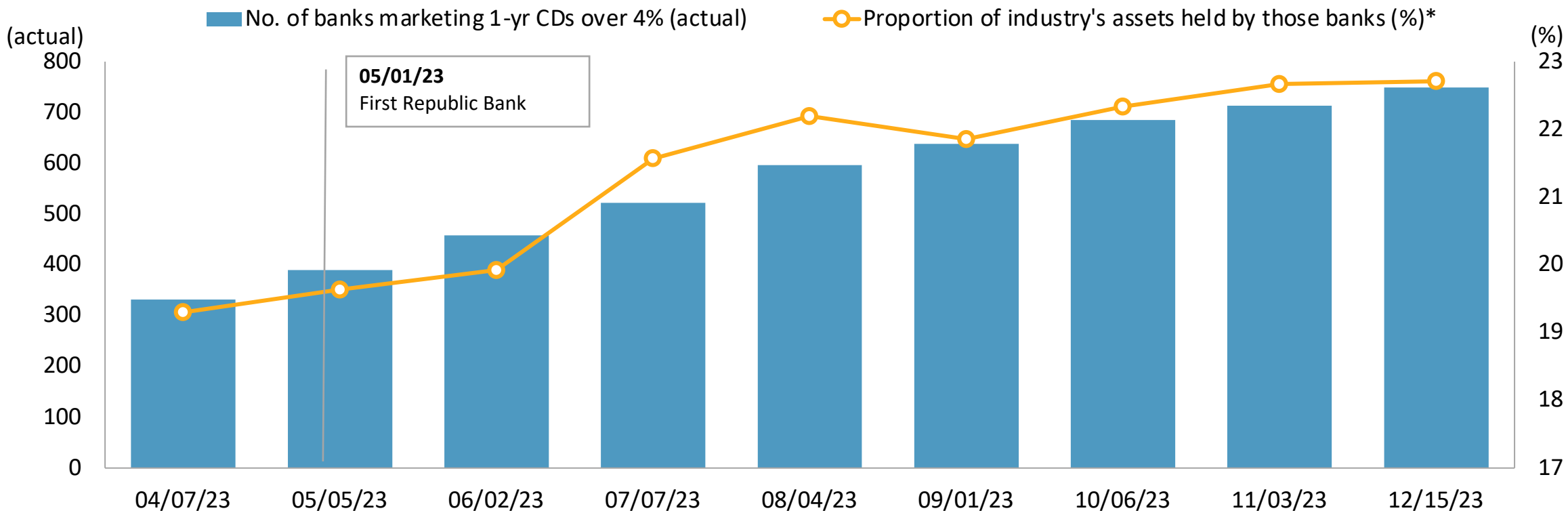
# Growing number of banks marketing 1-year CDs above 4%




Data compiled Dec. 18, 2023.
CD = certificate of deposit.
Analysis includes US commercial banks, savings banks, and savings and loan associations that filed regulatory reports as of June 30, 2023. Nondepository trusts and companies with a foreign banking organization charter are excluded.
Silicon Valley Bank, Signature Bank and First Republic Bank failed following a bank run.
* Total assets are based on regulatory filings as of Sept. 30, 2023.
Source: S&P Global Market Intelligence.

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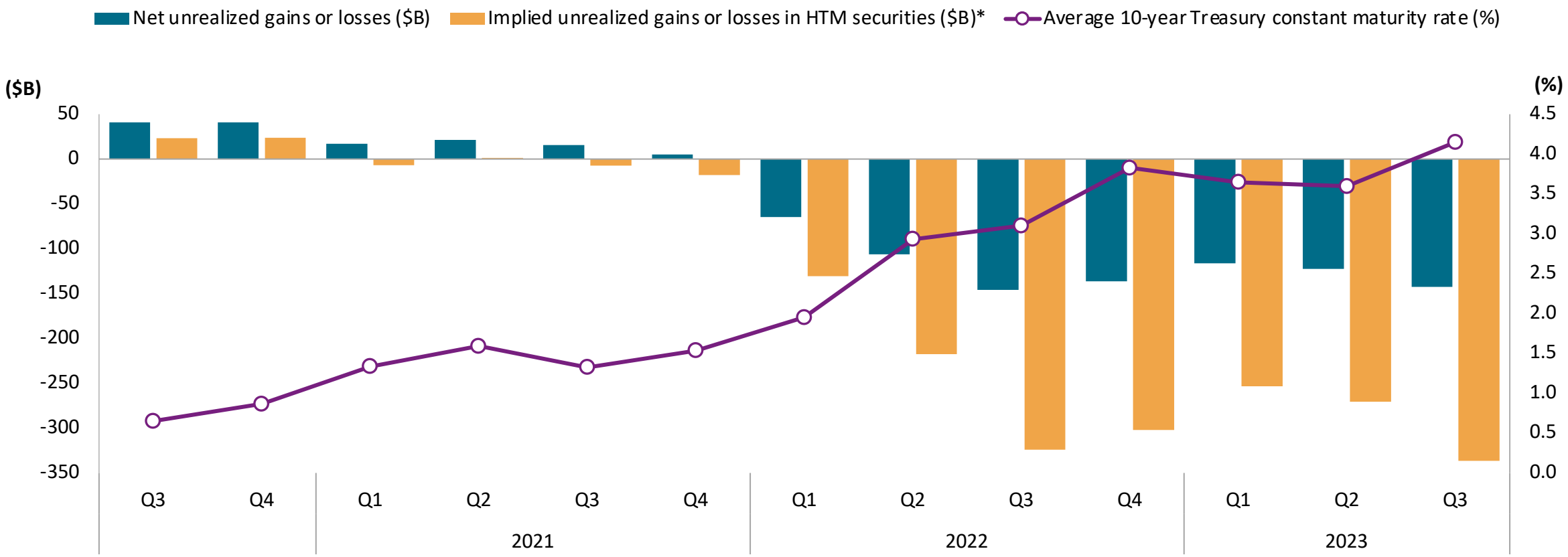
# More banks bite the bullet, reposition their bond portfolios

## Net unrealized gains/losses, implied losses on held-to-maturity portfolios at US public banks in Q3 2023




Data compiled Dec. 11, 2023.
Analysis based on operating and historical US public banks.
Net unrealized gains or losses based on GAAP filings.
* Data based on regulatory filings and represents the unrealized gains or losses on HTM securities by calculating the difference between the securities' fair value and amortized cost.
Sources: S&P Global Market Intelligence; Federal Reserve Board.

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# Liquidity concerns showing up in regulatory exams, capital plans

- **More focus on contingent liquidity, volatility in the investment portfolio during exams:** Liquidity component of CAMELS ratings negatively impacted during exams, scrutiny placing greater value on cash, deposits.
- **Regulators increasingly focused on tangible common equity:** TCE is loss absorbing capital. Regulators concerned that capital could be thin at this point in the credit cycle.
- **Lower TCE has implications:**
  - Banks with lower TCE face capital return restrictions, particularly those with elevated loan-to-deposit ratios.
  - Banks below 5% getting scrubbed by regulators.
  - Banks with anemic levels could see limited access to capital.
  - Banks below 0% faces limitations on borrowings from the Federal Home Loan Banks.

Data compiled Jan. 8, 2023.
CAMELS = capital adequacy, asset quality, management, earnings, liquidity and sensitivity.
Source: S&P Global Market Intelligence.



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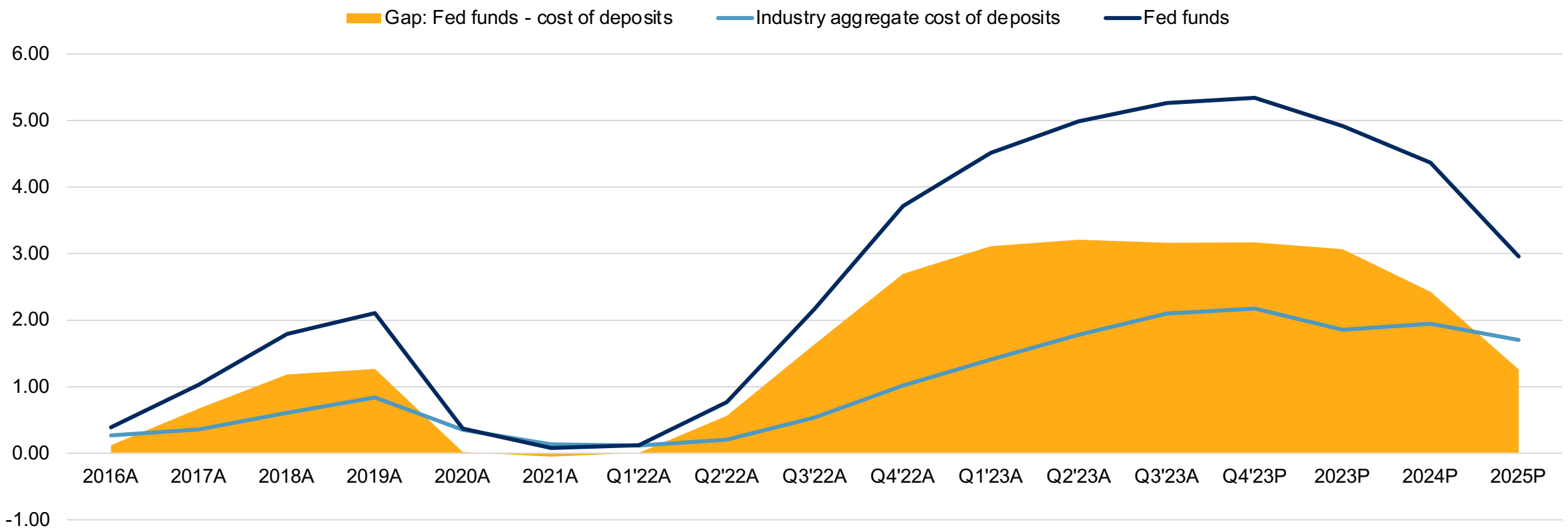
# Spread between deposit costs, fed funds is historically wide, driving outflows (%)




Data compiled Jan. 2, 2024.
A = actual; P = projected.
Cost of deposits = Interest expense on deposits/average deposits in the period, including noninterest-bearing deposits.
Sources: S&P Global Market Intelligence; proprietary estimates.

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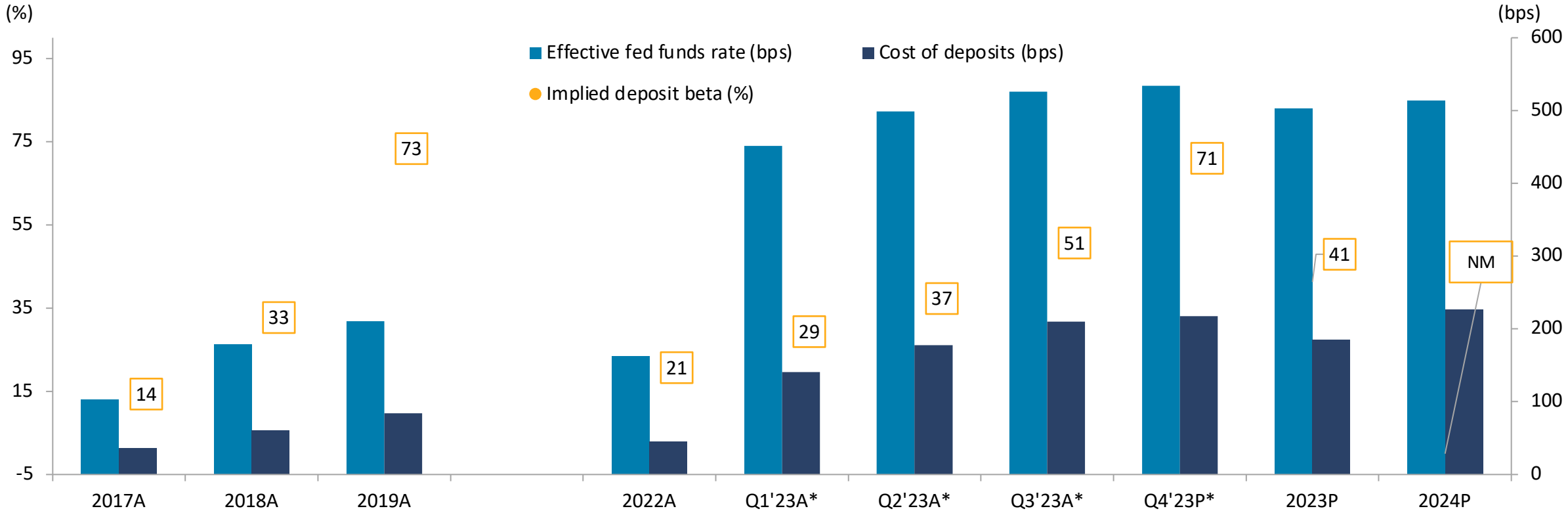
# Deposit costs continue to rise even with the Fed on hold




Data compiled Jan. 2, 2024.
A = actual; P = projected.
NM = Not material
* Represents YOY deposit beta
Figures for the federal funds rate are based on a 4-quarter average of estimates provided by IHS Markit.
Actual reported figures used when available.
Sources: S&P Global Market Intelligence, IHS Markit, proprietary estimates.

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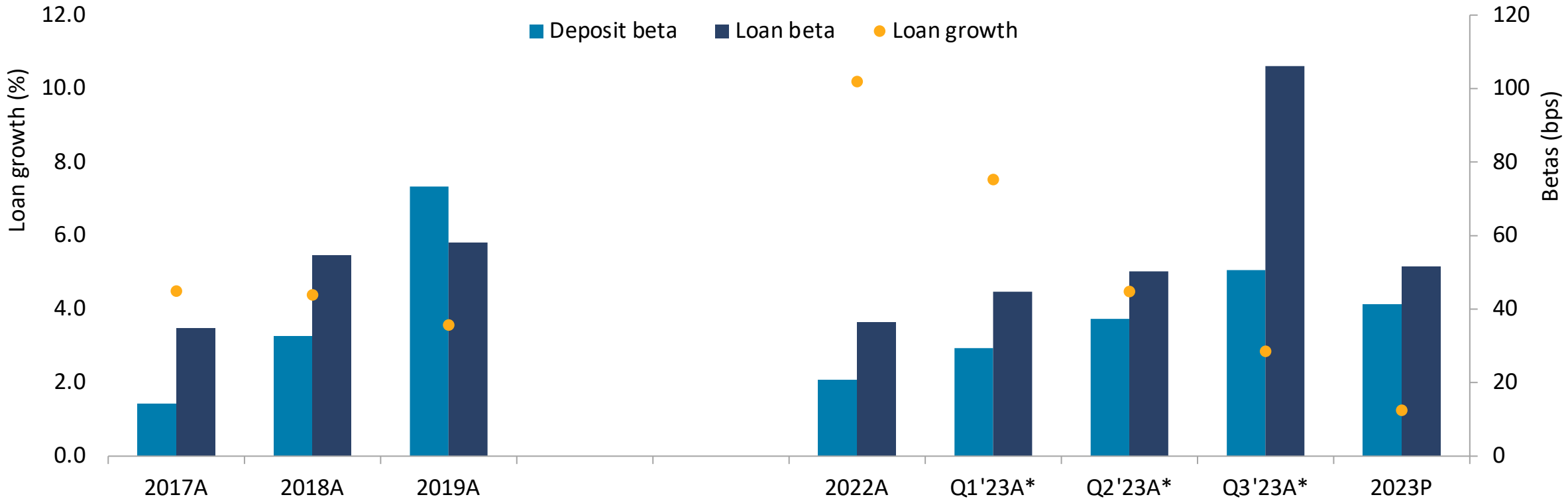
# Loan growth slowing as banks prize liquidity, eye credit risk




Data compiled Jan. 2, 2024.
A = actual; P = projected.
NM = Not material
*Represents YOY beta on loans and deposits.
Figures for the federal funds rate are based on a 4-quarter average of estimates provided by IHS Markit.
Actual reported figures used when available.
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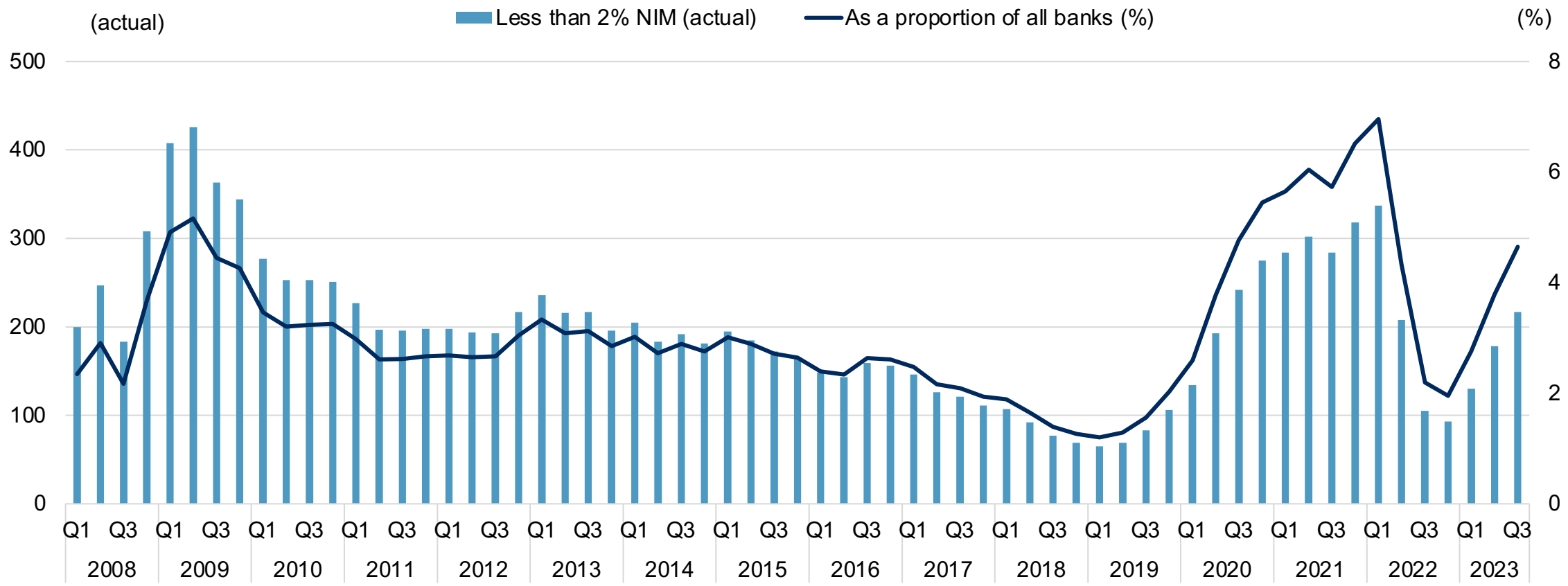
# Number of US banks with NIM of 2% or below spike in 2023

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Analysis includes all US commercial banks, savings banks, and savings and loan associations; excludes companies with a foreign banking organization charter.
Data based on regulatory filings.
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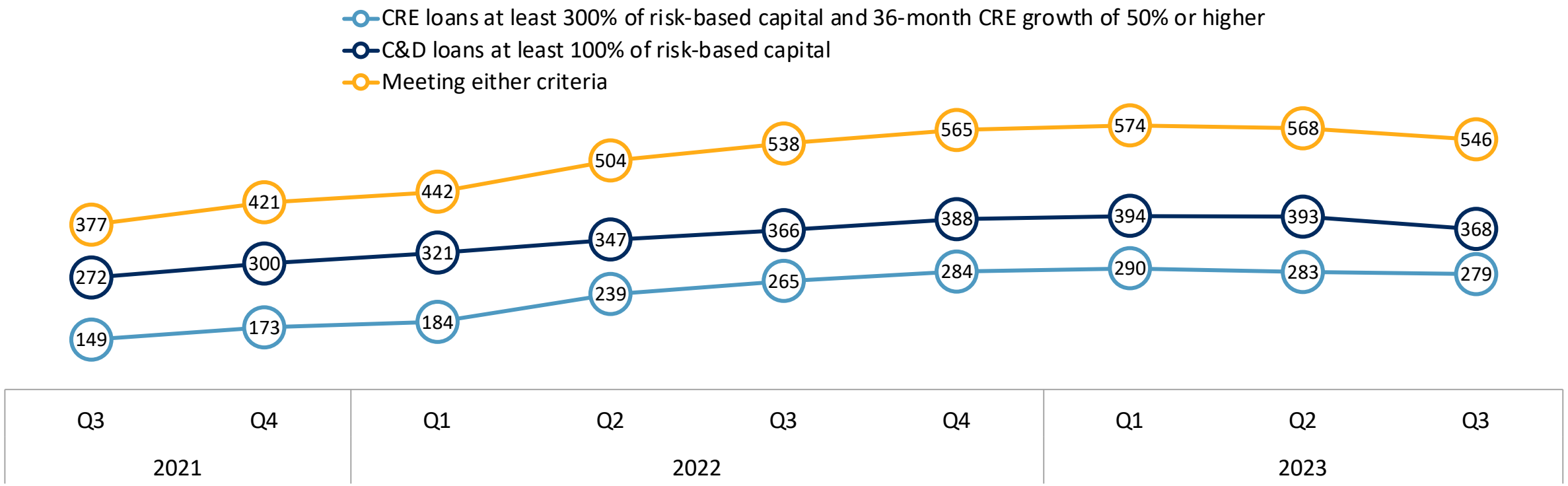
# Regulators subjecting banks with elevated CRE exposures to greater scrutiny

## Number of US banks exceeding 2006 CRE loan concentration guidance (actual)




Data compiled Nov. 20, 2023.
CRE = commercial real estate; C&D = construction and development; ALLL = allowance for loan and lease losses.
Analysis includes operating and historical US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.
Since the first quarter of 2020, regulators have recommended using Tier 1 capital plus the entire ALLL as the denominator in credit concentration calculations because of many banks qualifying for and opting into the community bank leverage ratio framework. Banks adopting the current expected credit loss model should use the portion of the credit losses attributed to loans and leases plus Tier 1 capital.
Companies that met both criteria are included in the totals for each criteria, causing overlap between the totals of each criteria.
Data based on regulatory filings.
Source: S&P Global Market Intelligence.

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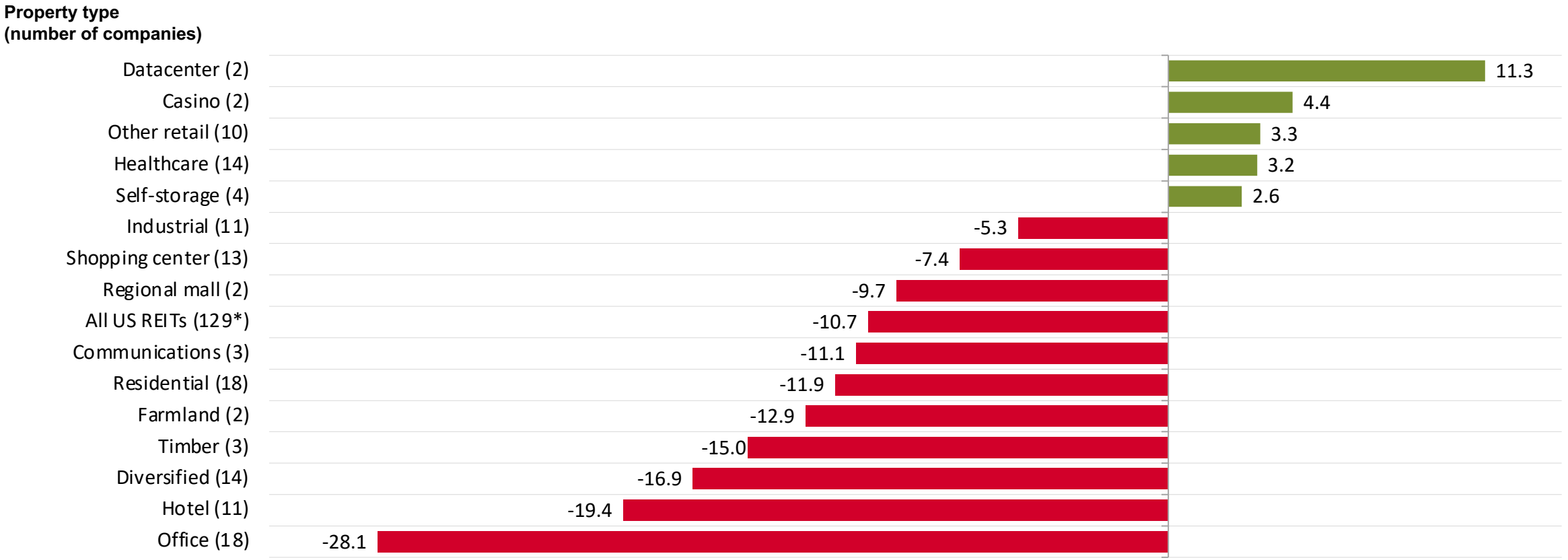
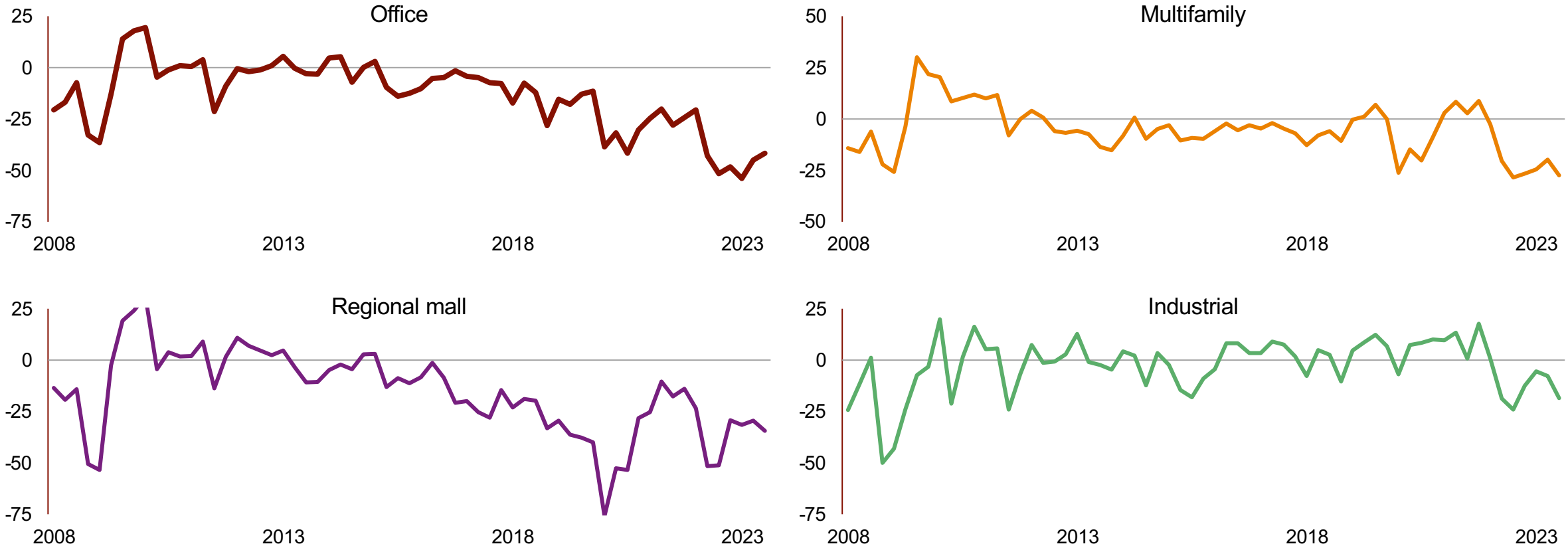
# Median premium (discount) to net asset value as of Dec. 31, 2023 (%)




Data compiled Jan. 2, 2024.
Includes US equity real estate investment trusts that trade on the Nasdaq, NYSE or NYSE American with market capitalizations of at least $200 million.
Other retail includes outlet centers, single tenant and other retail; residential includes multifamily, single family, student housing and manufactured homes.
* Includes two additional specialty REITs that are not reflected in a property type category.
Source: S&P Global Market Intelligence.

# Median discounts to net asset values grew in Q3 2023 for majority of US property sectors (%)




Data compiled Dec. 4, 2023.
Includes US REITs in the area of focus displayed that traded on the Nasdaq, NYSE or NYSE American with market capitalizations of at least $200 million as of each respective quarter-end.
Source: S&P Global Market Intelligence.

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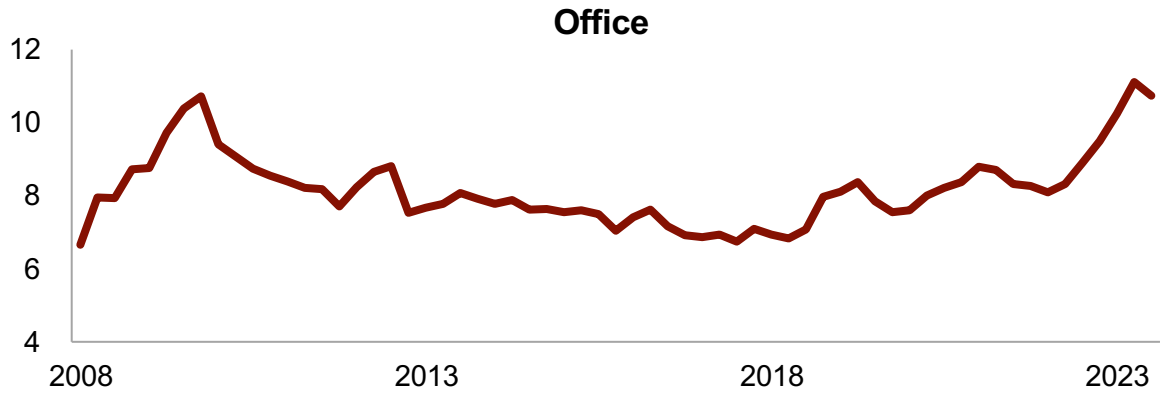
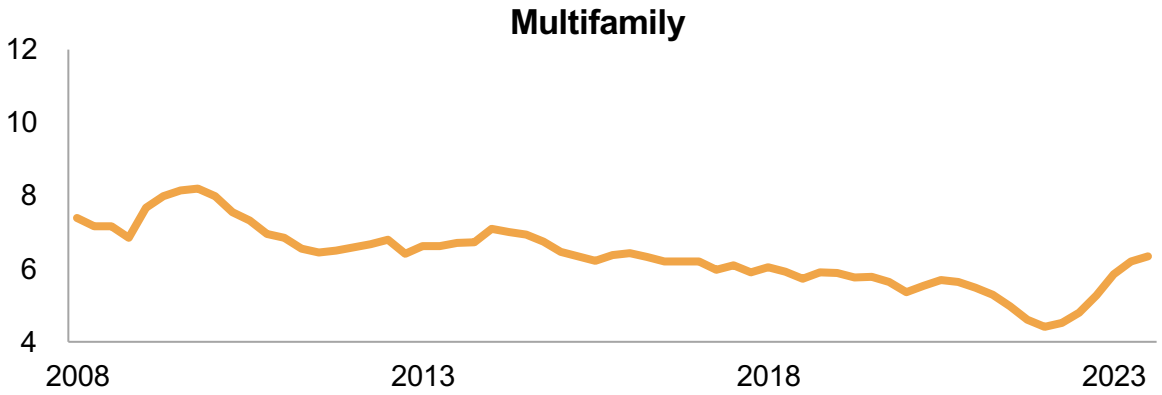
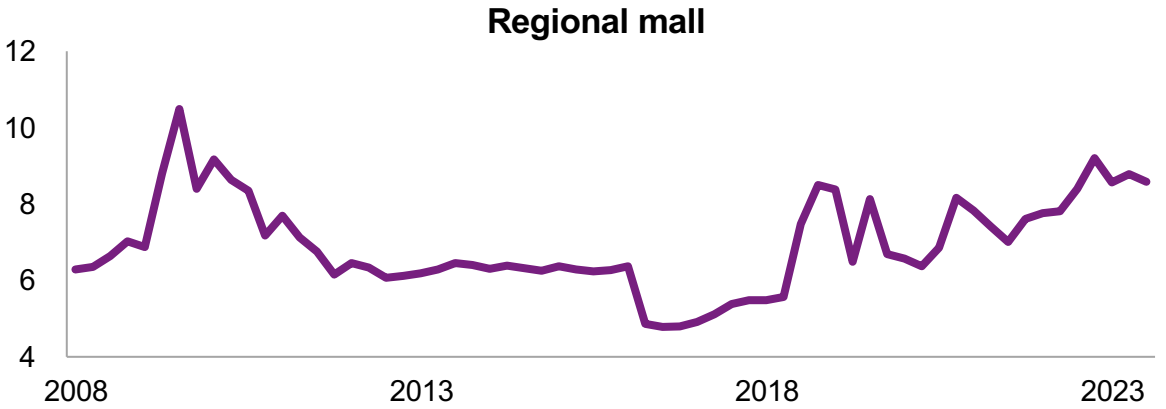
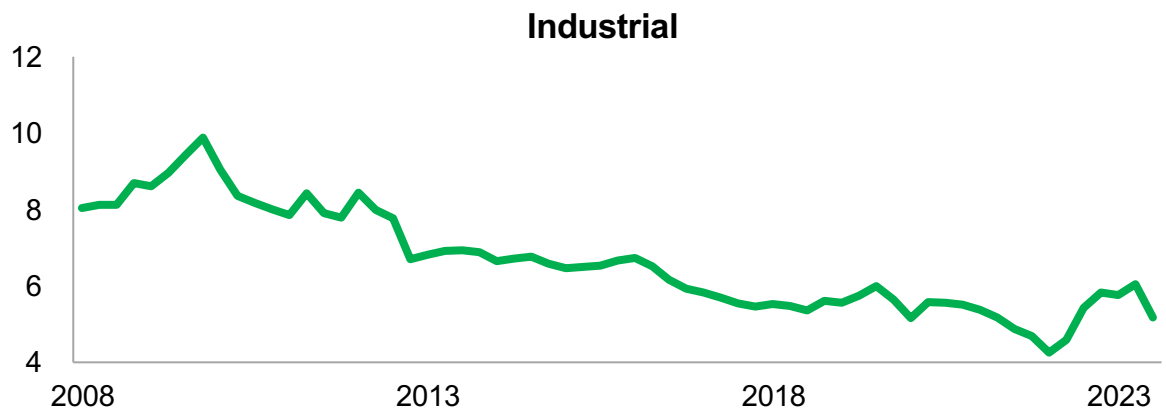
# Median implied capitalization rates remained high in Q3 2023 (%)



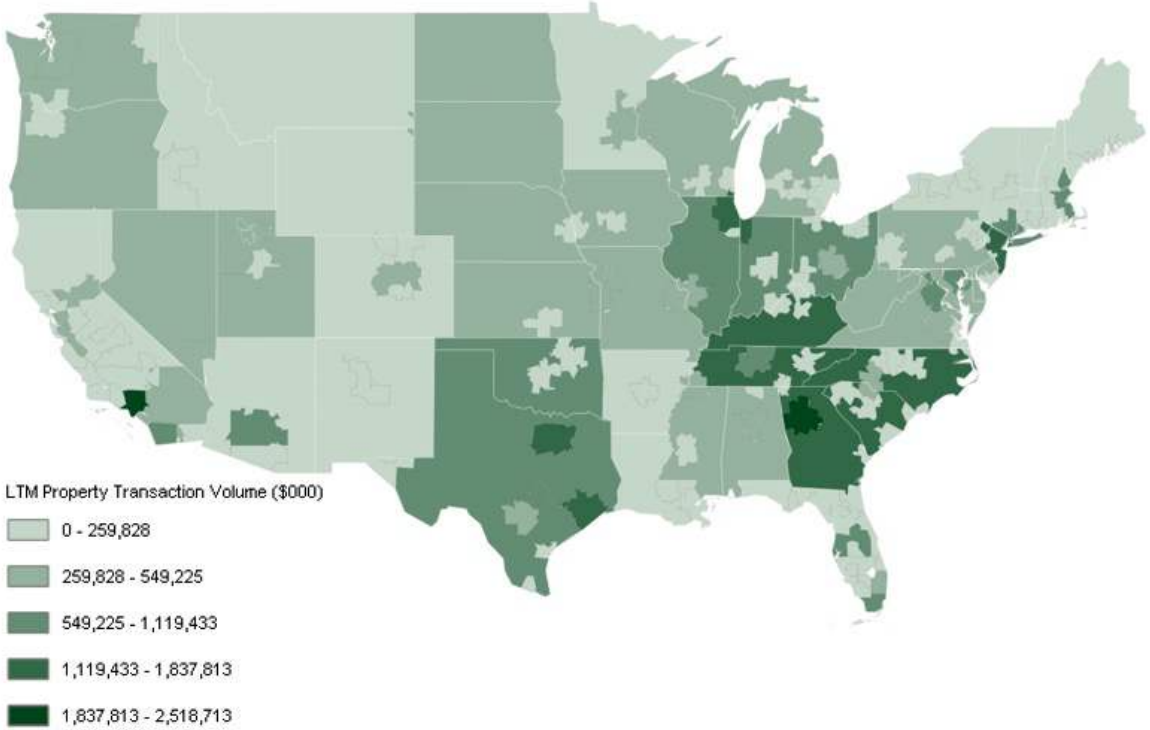

Data compiled Dec. 4, 2023.
Includes US equity real estate investment trusts that traded on the Nasdaq, NYSE or NYSE American with market capitalizations of at least $200 million as of each respective quarter-end.
Implied capitalization rate represents last-12-months property net operating income as a percentage of the implied market valuation of its real estate.
Source: S&P Global Market Intelligence.

# Retail and multifamily real estate transaction volume, 12 months ended Sept. 30

Activity was strongest in the Southeast region in the last 12 months, reflecting post-pandemic era macro dynamics, with particular strength in the Carolinas, Tennessee and Georgia.

**Real estate transaction volume by market in 12-months ended Sept. 30, 2023**

Retail




Data compiled Dec. 4, 2023.
Includes Real Capital Analytics markets by retail transaction volume in the twelve months ended Sept. 30, 2023.
Sources: S&P Global Market Intelligence; Real Capital Analytics.
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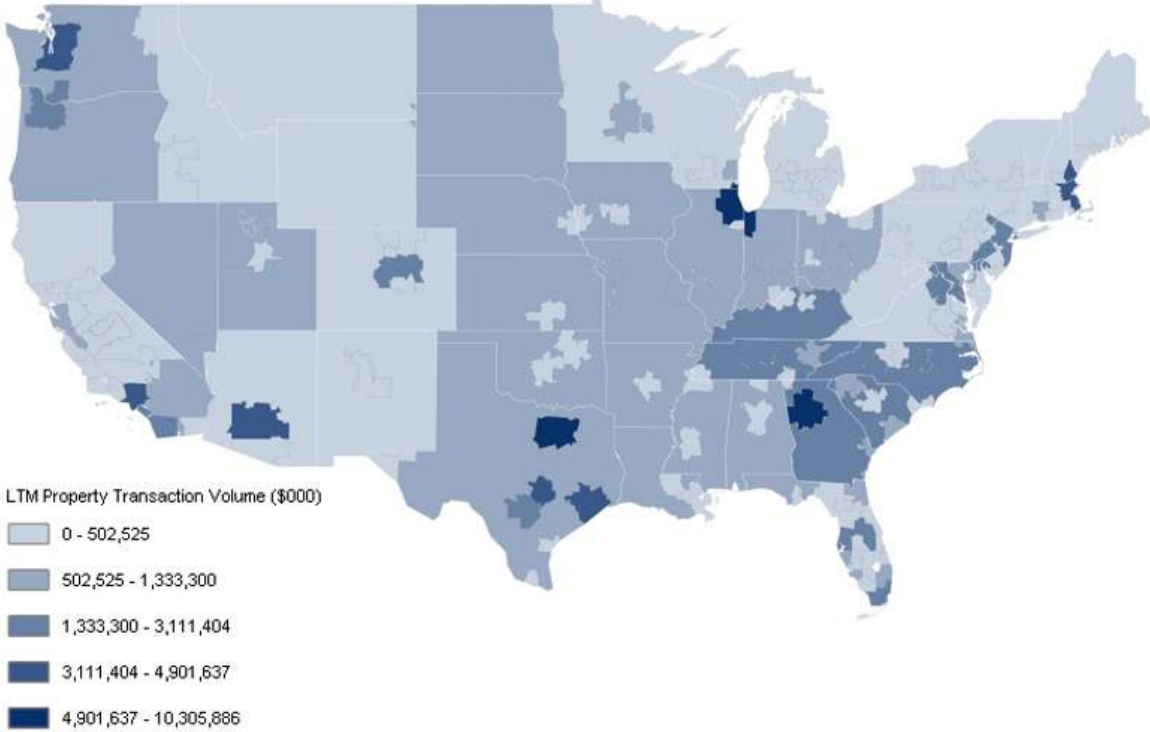
**Real estate transaction volume by market in 12-months ended Sept. 30, 2023**

Apartment




Data compiled Dec. 4, 2023.
Includes Real Capital Analytics markets by apartment transaction volume in the twelve months ended Sept. 30, 2023.
Sources: S&P Global Market Intelligence; Real Capital Analytics.
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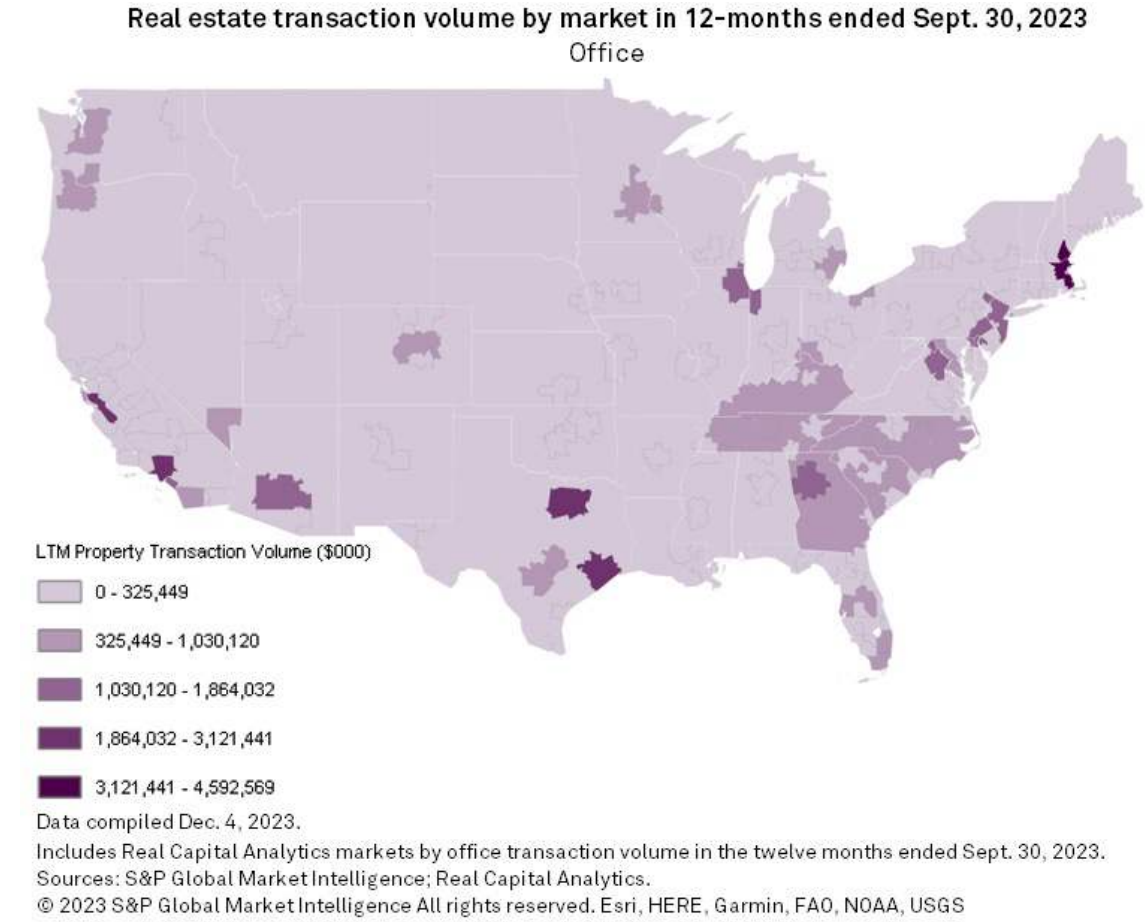
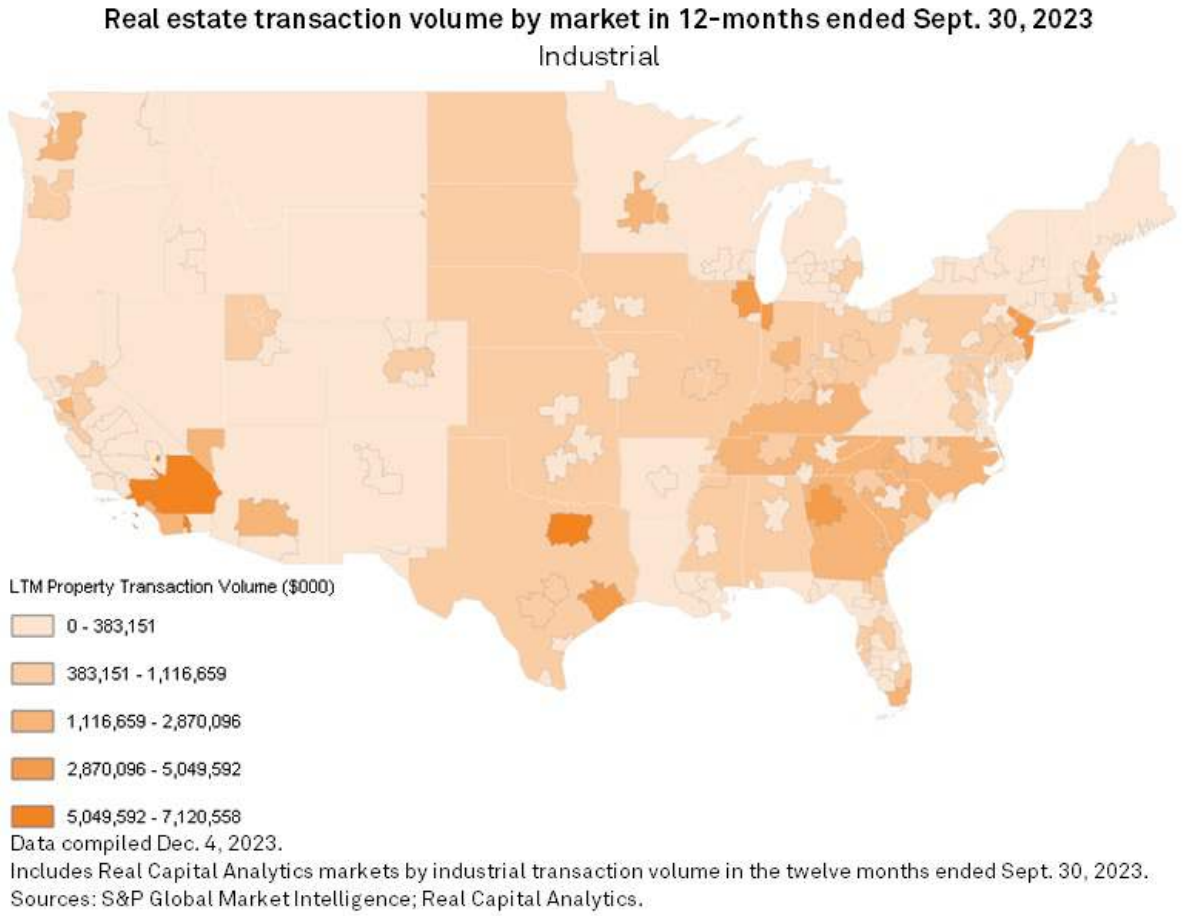
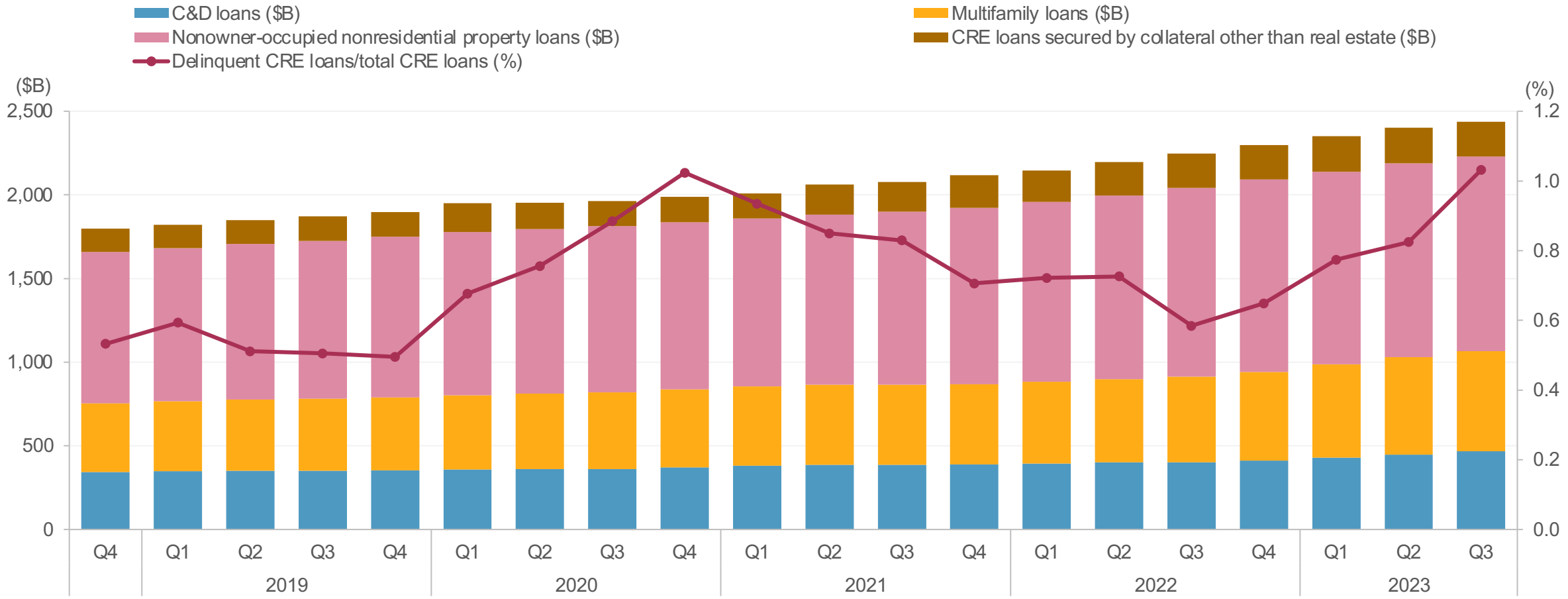
# Office and industrial real estate transaction volume, 12 months ended Sept. 30

Activity remained more focused on major population centers on a nationwide basis in the last 12 months, with the Southeast showing relative strength from a regional standpoint.



# US banks and thrifts faced 4th consecutive sequential rise in 30+ day delinquencies on nonresidential real estate loans in Q3 2023




Data compiled Dec. 7, 2023.
C&D = construction and development; CRE = commercial real estate.
Based on an aggregation of call report disclosures by US commercial banks, savings banks and savings-and-loan associations.
Source: S&P Global Market Intelligence.

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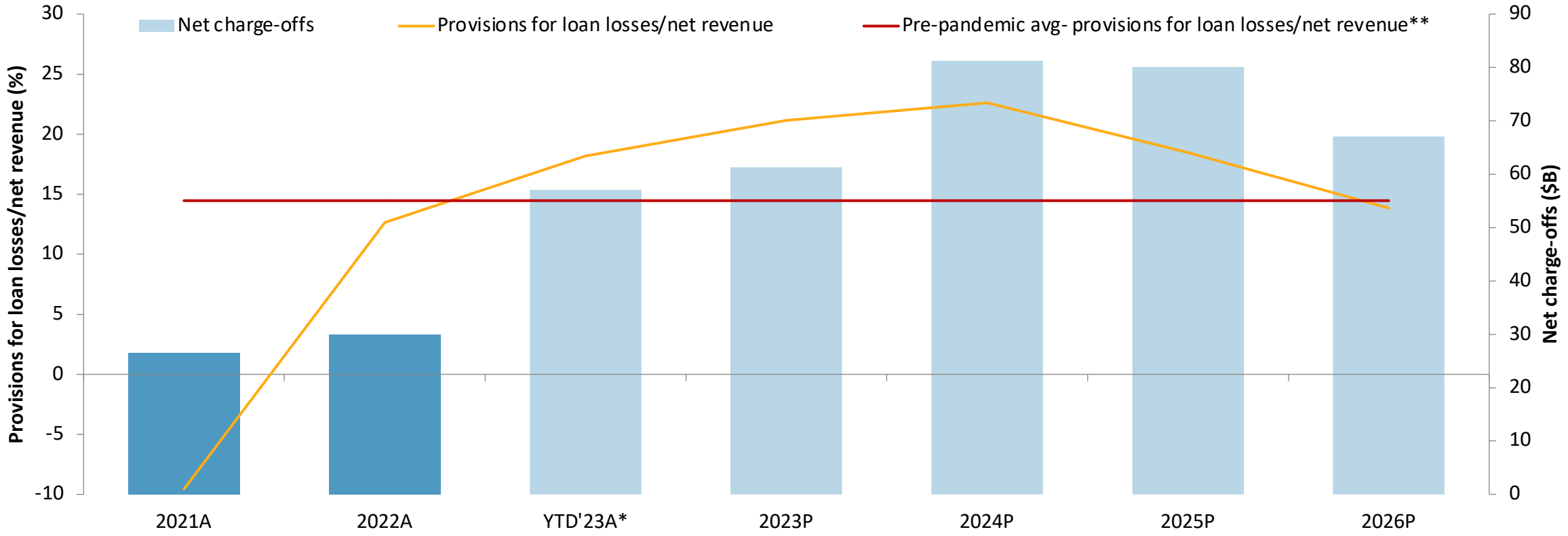
# Credit costs will rise substantially in 2024 but remain manageable (%)




Data compiled Jan. 2, 2024.
* Annualized.
** Average of provisions for loan losses/net revenue from 2013-2019. Net revenue = net interest income + noninterest income - noninterest expense.
Sources: S&P Global Market Intelligence; proprietary estimates



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# Bank margins under pressure as deposit mix shift continues, funding costs grind higher

## US banking industry aggregate profitability metrics (%)

- Earnings under pressure as margins contract, credit costs normalize.

| | YTD'23A | 2023P | 2024P | 2025P |
|---|---|---|---|---|
| Net interest margin | 3.21 | 3.18 | 3.12 | 3.14 |
| YOY earnings growth, excluding bargain purchase gains | 4.27 | -2.94 | -1.16 | 9.94 |

Data compiled Jan. 2, 2024.
A = actual; P = projected;
Sources: S&P Global Market Intelligence; proprietary estimates

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# Liquidity pressures slowing growth, leading to more restructuring, M&A down the road

- **Bank liquidity precious:** Deposit growth will return as banks continue to defend liquidity with higher rates but loan growth to remain slow.
- **Some banks reposition bond portfolios:** A number of banks have pruned their underwater bond portfolios to improve profitability, liquidity profile.
- **Bank earnings under pressure:** Bank earnings expected to fall in 2023, dip again as net interest margins fall further, credit costs rise. Earnings pressures should prompt more M&A talks.

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# Q&A

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# S&P Capital IQ Pro CRE resources

**Bank CRE exposure template:** Analyze a bank's CRE exposure, delinquencies and risk-based capital coverage.

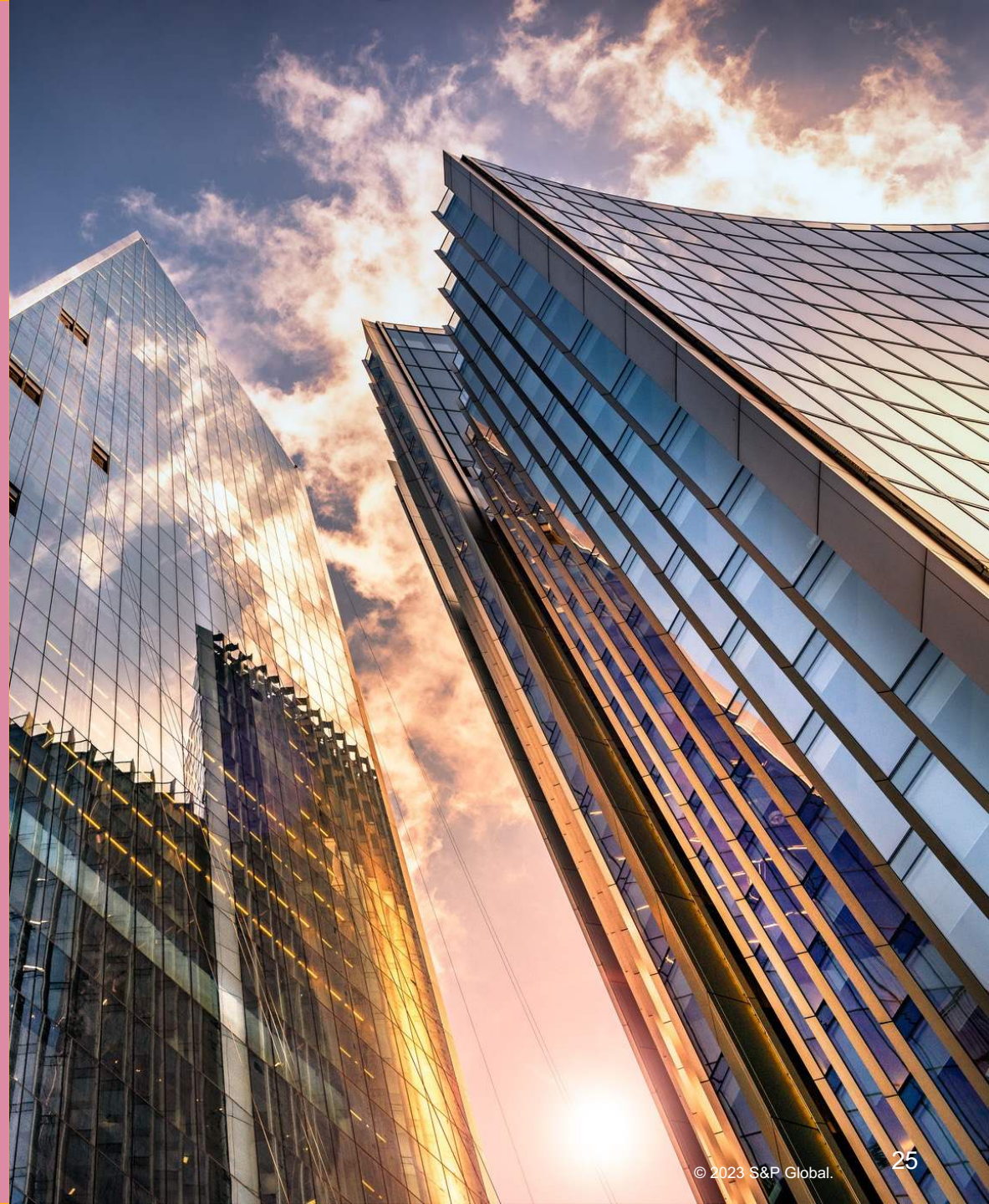
**Insurance investment transactions template:** Provides detailed and summary views across asset classes, including direct and indirect mortgage lending, for selected filing periods and entities.

**Commercial mortgage prospecting:** Uncover detailed property-level data by location, lender, land use, and maturity dates.

**REIT NAV Chart Book:** Overview of how REITs are trading relative to their consensus NAV estimates.

**REIT Capitalization Rate template:** Calculate a current implied capitalization rate utilizing a variety of methodologies.

**Real Estate Market Profile template:** Provides a market overview through aggregated real estate property data.



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