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T-ALLR Research

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Bank CRE Loan Performance: Originations Up, Delinquencies Down but Still Signs of Pandemic in Q3 2021

Originations of commercial real estate (CRE) mortgages rebounded in the third quarter, while delinquencies continue to trend down after a moderate rise in 2020. At a high level, conditions seem good in commercial real estate lending, however, COVID's impacts can still be seen. Delinquency rates are still elevated for lodging and retail, the property-type mix within originations has clearly shifted to the pandemic favorites (industrial and multifamily) and lenders are still casting a wary eye on urban office markets.

The analysis here is mainly built on an examination of trends in Trepp's T-ALLR data set. The T-ALLR data is comprised of bank balance sheet loan data, a diverse set of loans totaling over $160 billion sourced from multiple banks.

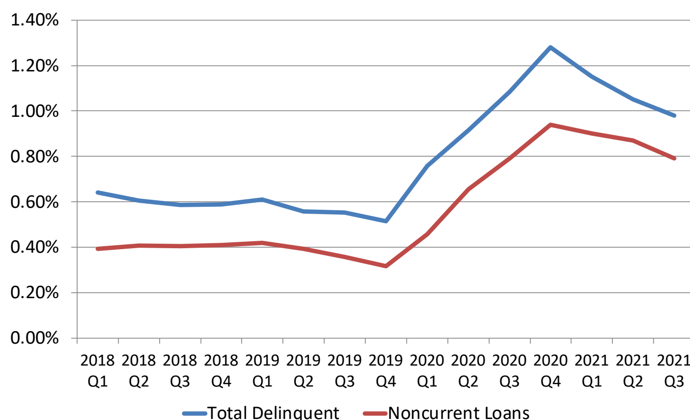
Delinquency Rates – Improving, But Still Elevated in Lodging and Retail

CRE mortgage delinquencies hit a recent peak of 1.3% in Q4 2020, as the pandemic disrupted economic activity across a broad range of geographies and industries. Since year-end 2020, the economic recovery has helped bring mortgage delinquency rates down, with modest improvements in the first three quarters of 2021. As of Q3 2021, the overall CRE delinquency rate stood at just under 1%, while the noncurrent (more serious delinquencies) rate stood at 0.8%, both still above their pre-pandemic levels.

The highest delinquency rates are in the two hardest-hit sectors within commercial real estate, lodging and retail, although the delinquency rate for retail has been improving throughout 2021. Delinquency rates for both lodging and retail – at 11.9% and 4.9%, respectively – edged up slightly in Q2, after showing noticeable improvement in Q1. The uptick in Q2 is a reminder that the path to recovery may be protracted over a longer period.

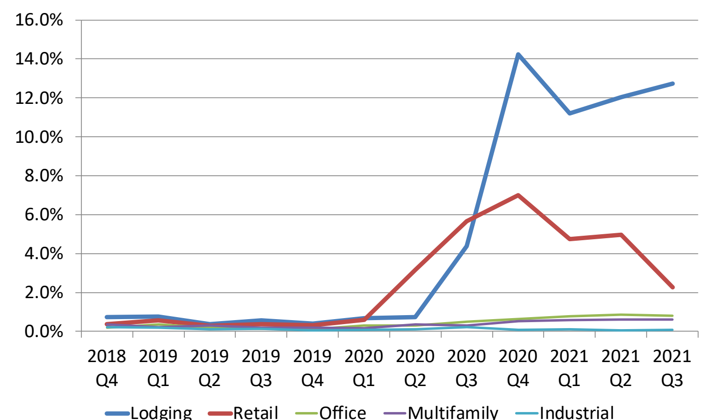
Delinquency rates for the other major CRE property types are below 1%. However, the office delinquency rate has risen to 0.9%, up from its pre-pandemic 0.1% rate. Similarly, the multifamily delinquency rate has risen to 0.6%, from 0.2% before COVID hit in early 2020. The industrial delinquency rate is very low at 0.1%, reflecting the strength of the sector through both the recession and recovery.

FIGURE 1: BANK CRE LOAN PERFORMANCE DELINQUENCY RATES PEAKED IN LATE 2020



Source: Trepp Bank Navigator

FIGURE 2: DELINQUENCY RATE BY PROPERTY TYPE CONTINUED STRESS IN HOTELS, IMPROVEMENT IN RETAIL



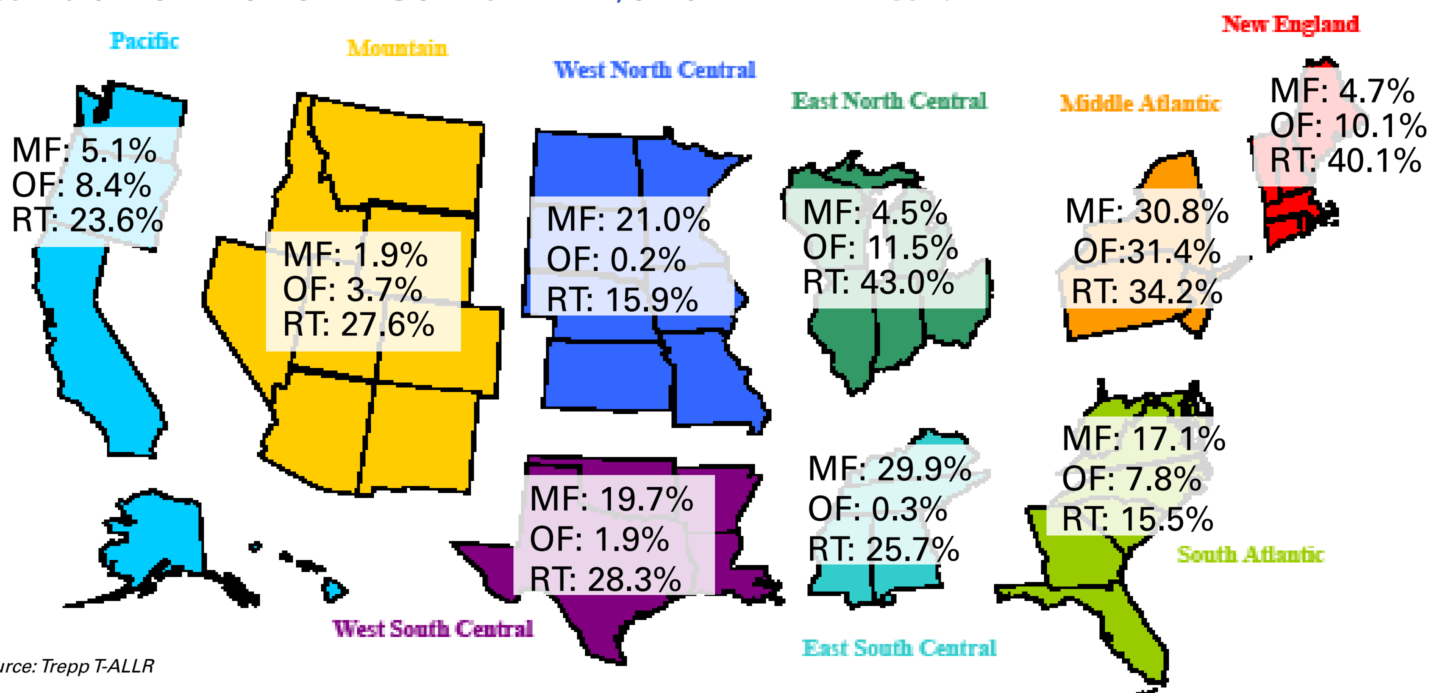
Source: Trepp T-ALLR

Risk Ratings – Broad Concerns About Retail, Regional Differences in Office and Multifamily

Criticized loan rates[1] show significant variation across geographies and property types. When the pandemic hit in the first quarter of 2020, lenders were allowed to offer forbearance to COVID-impacted borrowers. If a borrower received forbearance, the loan would not be marked as delinquent. However, the lender was expected to update its risk rating on the loan, to reflect the lenders' expectations for ultimate re-payment of the loan. So, while delinquency rates have shown a more muted response to the economic disruption of 2020, risk ratings started to adjust immediately.

- Lenders in the Mid-Atlantic have elevated concerns about risk across all three of the largest property types. More than 30% of loans – by loan balance – in the multifamily, office and retail property types carry risk ratings of 6 or higher. Pandemic-related concerns are still evident in the higher risk ratings.
- Risk ratings for office loans have increased, especially in the largest markets, as the long-term prospects for the sector have become less certain. The large and commuter-dependent New York office market is the source of the Mid-Atlantic's high 31% proportion of criticized loans. The other large metro areas with large CBD office markets – such as Boston and Chicago – are also driving double-digit proportions of criticized loans in the New England and East North Central areas.
- Multifamily generally has a low proportion of criticized loans. However, lenders in several areas – from the West North Central area, through the South and up to the Mid-Atlantic area – were keeping a closer eye on multifamily. A slew of income and renter protections that were put in place in response to the pandemic and its disruption to the economy were set to expire in the third quarter of 2021.
- Retail loans are widely perceived to be at higher risk, with double-digit proportions of loans in the Criticized category. The areas with the highest proportions of Criticized loans were East North Central, Mid-Atlantic and New England.

FIGURE 3: CRITICIZED LOANS BY REGION MULTIFAMILY, OFFICE AND RETAIL – Q3 2021



Source: Trepp T-ALLR

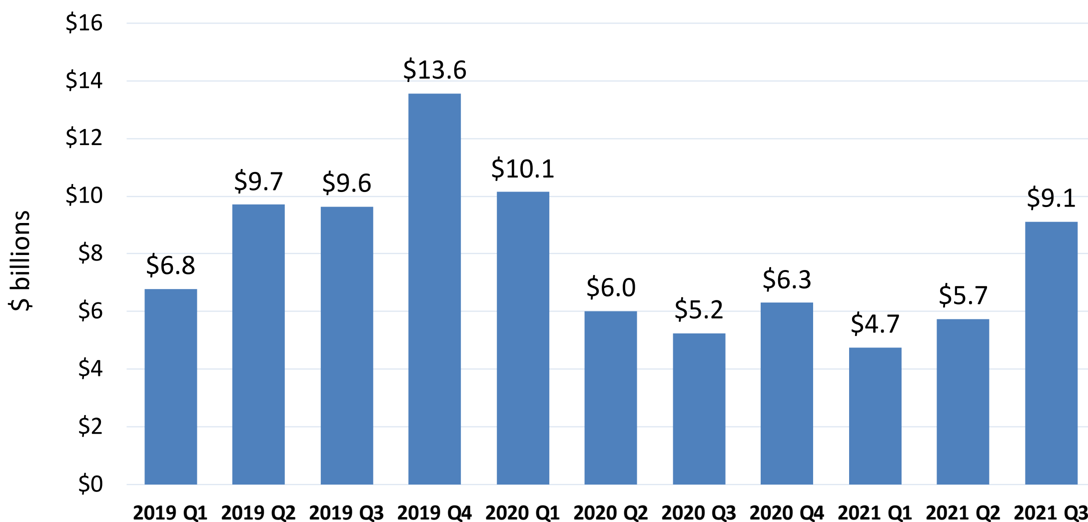
[1] Criticized loans have a standardized risk rating of 6 or higher. As part of its data collection and anonymization process, Trepp translates contributors' internal risk ratings to a standardized risk rating that ranges from 1 (lowest risk) to 9 (highest risk) for default and loss.

Origination Volume – Recovery Being Led by Industrial and Multifamily

New CRE loan originations increased substantially in Q3 2021 to nearly the pace seen in 2019. With economic growth, currently low interest rates, and the prospect for higher rates ahead, there is plenty of capacity for more borrowing.

- Industrial volumes have more than doubled when compared to pre-pandemic levels, as lenders and investors have driven investment activity to record levels. The shift to online shopping and delivery has given a boost to the sector which was already growing rapidly. Concerns about supply chain susceptibility to disruption will likely lead to increased production of industrial space.
- Multifamily originations have caught up and surpassed the average pace in 2019. Despite increased concerns about the risk levels of some existing loans, multifamily is still seen as a safe sector and loan performance has been strong throughout the pandemic. Banks are competing with other lenders – especially the GSEs – so liquidity within the multifamily sector is high.
- Office origination volumes are increasing but are still about 25% below pre-pandemic levels. Despite concerns about the long-term outlook for office, lenders and investors are still finding deals they can get comfortable with.
- After an uptick in Q2, retail loan originations fell in Q3 and remain about 50% below 2019 levels. As one of the hardest-hit real estate sectors in the 2020 downturn, lenders are treading cautiously.
- Lodging is still an unloved sector, with loan originations off by nearly 80% from the pace in 2019. The few loans that are being made have higher DSCRs and lower LTVs than pre-pandemic loans.

FIGURE 4: COMMERCIAL MORTGAGE ORIGINATION VOLUME GETTING BACK ON TRACK



	Q3 2021 AS % OF 2019 AVERAGE
Multifamily	123%
Office	71%
Retail	45%
Lodging	22%
Industrial	233%
Total	92%

Source: Trepp T-ALLR

Looking Ahead – Near-term Volatility, Longer Term Inflation Might not be All Bad

In the near term, financial and real estate markets face some added volatility, in the form of Omicron disruptions and higher inflation. Omicron has notably disrupted travel, which will likely stretch out the recovery for the lodging sector, as well as businesses' return-to-office plans, which will add to the lingering concerns about the office sector. But economic and employment growth is most likely set to continue, which will underpin increased demand in all real estate sectors.

Inflation is another concern, with near-term negative impacts of reduced disposable income and higher interest rates. These impacts could diminish demand and reduce real estate values (through higher borrowing costs). But longer term, inflation should lead to higher rents and higher real estate valuations. With higher income and higher values, existing loans will see DSCRs increase and LTVs decrease, which will make today's loan portfolios look less risky in the future.

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For more information about Trepp's commercial real estate data, contact info@trepp.com.
For inquiries about the data analysis conducted in this research, contact press@trepp.com or 212-754-1010.

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About **T-ALLR**

Trepp's Anonymized Loan Level Repository (T-ALLR) houses CRE and C&I data from large and mid-sized commercial banks. The T-ALLR Data Feed contains anonymized loan level and period level attribute and performance information on each loan. With 7+ years of history and new quarterly originations typically exceeding $7 billion for CRE and $9 billion for C&I, T-ALLR provides the breadth and depth necessary to gain insights into market activity, identify trends, and spot emerging pockets of risk and opportunity.

The information provided is based on information generally available to the public from sources believed to be reliable.