

# Banks starting to take a hit from commercial property downturn

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They have taken some time to work their way through, but it appears the interest rate hikes by the US Federal Reserve and other major central banks over almost two years are starting to hit commercial property, and the banks that have made loans to this sector.

This week, three banks on three different continents revealed significant losses and problems due to their exposure to commercial property.

On Wednesday, shares of New York Community Bancorp (NYCB) fell 38 percent, followed by a further 11 percent decline the next day, after it revealed it had made provision for losses running into tens of millions of dollars on commercial property loans.

On Thursday, shares in the Tokyo-based Aozora Bank fell more than 20 percent, the largest amount allowed under stock market rules. This came after it announced its expected profit for the year ending in March had been transformed into a loss because overseas real estate loans had gone sour.

In Switzerland the private bank Julius Baer revealed it had taken a \$700 million hit from the failure last year of the Austrian property group Signa.

In a sign of the worsening situation in the US commercial property market, Deutsche Bank said it was increasing the loss provisions for American commercial loans from the fourth quarter of 2023 to \$123 million, a rise of nearly five-fold from 2022.

The banks have their own individual characteristics and peculiarities, such as the competency of their managements.

But their common feature is that the transition, from virtually near zero interest rates for more than a decade after the financial crisis of 2008 to the rate hikes that started in 2022, has hit their bottom line. That means there are more problems building up in the sector,

particularly for middle-sized banks.

The case of NYCB is a graphic expression of the fragilities of the stock market. NYCB was one of the beneficiaries of the collapse of Signature Bank last year after taking it over at the height of the crisis in March last year when regional banks experienced deposit runs.

Its stock price soared, only to come crashing down after it revealed it had taken \$185 million in losses on just two property loans and had set aside more than \$500 million to cover potential losses.

Reporting on the NYCB losses, the *Financial Times* pointed to the dilemma that confronts many medium-sized banks with regard to the commercial property sector.

“Most banks want to reduce their exposure to this \$5.8 trillion market. A record amount of loans are maturing and need refinancing this year and the next. Yet they need the high-yield loans to finance the generous deposit rates required to attract savers.”

The deposit issue emerged in the crisis last March when depositors started shifting their money to larger banks, fearing the problems which had engulfed the three that failed—Silicon Valley Bank, Republic Bank and Signature Bank—were not confined to them.

Data from NYCB showed that it paid average rate of 3.62 percent on its interest-bearing deposits in the fourth quarter compared to 1.93 percent a year ago. By comparison, the interest rate paid by the banking giant JPMorgan was 2.78 percent.

The sharp turn in the position of Aozora exemplified the effect of the deepening problems of the US commercial real estate market.

Although they accounted for only 6.6 percent of total loans, the potential losses transformed an expected profit of 24 billion yen (\$164 million) into a probable loss of the same magnitude. Its stock price, which had

been around a five-year high, then plunged setting off mandatory trading restrictions after the fall went beyond 20 percent.

In an indication of the depth of the downturn, Aozora reported that of the \$1.89 billion worth of loans on its books, some \$719 million were non-performing, that is more than 90 days overdue dates for payments.

The highest concentration of non-performing loans was in Chicago where the bank said “a considerable amount of time is required to recover supply and demand balances in urban areas,” noting that “the volume of property sales remains very low.”

The slump in commercial real estate and the problems it brings for banks has been the subject of some commentary.

Bank of America analysts wrote that the higher losses were a “a reminder of going credit normalisation that we are likely to witness across the industry.”

This is, to say the least, something of an understatement. The crisis in real estate is not some “normal” conjunctural downturn. It is another expression of the deep crisis which exploded to the surface in 2008 and which created a financial system which now requires massive state support to keep functioning whenever it runs into problems. This was seen in the freeze of the Treasury market in March 2020 and in the banking crisis of 2023.

In commercial real estate, loans and property development projects have relied on the provision of ultra cheap money. So the maintenance of an interest rate above 5 percent for a period of time—once considered entirely normal—threatens major financial problems of which what has surfaced so far are a foretaste.

According to a *Wall Street Journal* report, some \$2.2 trillion worth of US property loans are set to come due by 2027. Some banks are already giving short extensions to loans that were due in the past two years.

Speaking at the World Economic Forum last month, Anne Walsh, the chief investment officer with Guggenheim Partners Investment Management, said: “The commercial real-estate pain in the office sector is just starting.”

She likened the situation to a “rolling recession” for banks that could drag on for some time.

The risk, as noted in the *Global Financial Stability* report of the International Monetary Fund

issued last October, is that it could development into something more.

Warning of the possibility of a significant fall in commercial property prices, the IMF said such a situation had the potential to create “a vicious cycle of tighter funding conditions, falling CRE prices, and bank losses, with broader implications for macrofinancial stability.”

It updated its assessment last month in a blog post which described the fall in commercial property prices as “striking” and that they had “plummeted more in the present monetary policy tightening cycle than in previous episodes.”



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