

Banking & Finance

AN EIGHTH DISTRICT PERSPECTIVE

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Real Problems in Real Estate?

Much concern has been voiced recently about the health of banks and thrift institutions due to an alleged rise in the riskiness of their real estate loan portfolios. The increased risk is attributed popularly to a wide range of economic factors which includes overly ambitious lending programs, lower-than-anticipated rates of property appreciation, the use of variable rate mortgages, as well as various aspects of both fiscal and monetary policy.

This issue examines the real estate lending activities of Eighth District banks. The growth rates of residential and nonresidential real estate loans over the past five years are highlighted and broken down to permit analysis of real estate lending trends in the District's four major metropolitan statistical areas (MSAs): Little Rock, Louisville, Memphis and St. Louis. Comparisons with U.S. data are also indicated. Data on loan delinquencies and past due loans do not support the preceding allegations about real estate loans and bank profitability. While the data indicate that real estate loan losses have risen slightly at banks, the evidence does not suggest that bank problems in the Eighth District can be attributed to real estate lending difficulties.

Growth in Real Estate Lending 1981-85

Data from banks' first-quarter 1985 Reports of Condition indicate that real estate loans constituted 35 percent of all bank loans in the Eighth District as compared to 30 percent for the national average. Over the 1981-85 period, real estate loans in the U.S. and the Eighth District grew at rates of 9.4 percent and 8.3 percent, respectively. Within the major MSAs of the District, annual growth over the past five years has been as rapid as 18.5 percent in Little Rock and as slow as 2.5 percent in St. Louis. Memphis also posted a rapid growth in real estate lending over the past five years with a rate of 17.4 percent, while Louisville was near the national average with an 8.8 percent rate. Table 1 displays annual growth rates for real estate loans and divides them into residential or nonresidential categories. It shows that at both national and District levels, real estate loan growth has been steadily accelerating

Table 1
Real Estate Loans Outstanding as of March 31
(Growth Rates from the Previous Year)

	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
U.S.				
Total Real Estate Loans	12.4%	11.7%	5.2%	8.4%
Residential	7.5	7.7	1.5	6.3
Nonresidential	18.5	16.5	9.9	11.0
District				
Total Real Estate Loans	14.4	12.6	4.3	2.2
Residential	11.9	10.9	5.5	3.7
Nonresidential	17.4	14.8	2.8	0.5
Little Rock				
Total Real Estate Loans	10.7	24.7	49.6	-4.5
Residential	8.8	3.1	128.6	-15.2
Nonresidential	12.4	53.6	2.2	3.4
Louisville				
Total Real Estate Loans	21.4	17.8	-2.5	0.3
Residential	11.7	18.2	-5.0	2.0
Nonresidential	30.6	17.4	0.1	-1.3
Memphis				
Total Real Estate Loans	31.4	35.1	4.4	2.5
Residential	10.8	38.8	-1.9	5.8
Nonresidential	52.8	31.6	11.5	-0.9
St. Louis				
Total Real Estate Loans	16.8	-13.2	3.3	5.2
Residential	11.4	-16.8	3.3	6.8
Nonresidential	23.9	-8.0	2.6	3.0

over the past five years, although this trend is less clear at the MSA level. The acceleration also is shown to have been the result of an expansion in nonresidential lending, which has generally been more rapid than the expansion of residential real estate lending.

Past-Due Real Estate Loans

Data on the volume of real estate loans considered past due by banks are available for the last three years. If the initial suppositions of increasing problems with real estate loans were true, one would expect this to be corroborated by rising levels of real estate loans past due.



TABLE 2
Percentage of Real Estate Loans
Classified as Past Due on March 31

	<u>1985</u>	<u>1984</u>	<u>1983</u>
U.S.	3.3%	3.5%	4.3%
District	3.4	3.7	4.0
Little Rock	3.7	4.3	4.6
Louisville	2.4	2.5	3.6
Memphis	2.8	2.5	3.6
St. Louis	2.2	2.8	2.9

The data in table 2, however, tell the opposite story, as the percentages of real estate loans considered past due have fallen at the national, District and MSA levels.

Problem Real Estate Loans

In addition to past due loans, banks with total assets greater than \$100 million are required to report those real estate loans considered to be either in nonaccrual or in renegotiated "troubled" debt status. These loans are referred to here as "problem loans." Table 3 also shows that the alleged real estate lending problems are not borne out by the data. The proportion of problem real estate loans has steadily decreased in the nation, in the District and in all but one MSA.

Real Estate Loan Losses

Detained reports of loan losses by loan purpose, such as real estate lending, are available only for the five most recent quarters, which permits a year-over-year comparison for the first quarters of 1984 and 1985. One limitation to using first-quarter data from income statements as opposed to balance sheet data is that a bank's performance over one quarter may not be representative of its performance over the entire year. This data problem is lessened as the number of banks sampled increases. This suggests that loan loss data for the nation and for the District would be more accurate than for the individual MSAs in which relatively small numbers of banks are located. With this in mind, real estate loan losses expressed as a percentage of real estate loans outstanding indicate that losses on real estate loans have

TABLE 3
Percentage of Real Estate Loans
Classified as Renegotiated "Troubled" Debt
on March 31 at Banks Larger than \$100 million of Total Assets

	<u>1985</u>	<u>1984</u>	<u>1983</u>
U.S.	1.9%	2.0%	2.7%
District	1.6	1.7	2.3
Little Rock	3.4	2.3	2.5
Louisville	1.7	3.1	3.7
Memphis	2.3	2.7	4.9
St. Louis	1.3	1.5	2.5

been quite small on an absolute level. They have increased, however, from .03 percent of real estate loans outstanding in first quarter 1984 to .04 percent in first quarter 1985 in the U.S., and from .05 percent to .06 percent in the District.

Problem Banks and Real Estate Lending

One further way of testing the assertion that real estate lending difficulties contribute to poor bank performance is by examining those banks currently experiencing stress. If real estate loan losses represent a higher proportion of total loan losses at problem banks than at banks experiencing more normal conditions, real estate loans could be implicated as important factors in banks' deteriorating health. A problem bank, for the purpose of this study, is defined as one with a volume of past due and problem loans greater than the volume of its capital and loan loss reserves. Real estate loan losses of problem banks were compared with the loan loss experiences of "normal" banks, i.e., those at which past due and delinquent loans were less than half of the bank's volume of capital and loan loss reserves.

At the national level, real estate loan losses accounted for 12.7 percent of total losses at problem banks vs. 9.9 percent at normal banks. At the District level, however, real estate loan losses accounted for a smaller proportion of total losses (15.6 percent) at problem banks than at normal banks (17.6 percent). These data indicate that, while at the national level real estate loans may have contributed to banks' difficulties, albeit to a relatively minor extent, Eighth District banks do not appear to have been disproportionately affected by real estate lending problems.

—Kenneth C. Carraro

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EIGHTH DISTRICT BANKING DATA

LARGE WEEKLY REPORTING BANKS¹

	Level II/1985 (\$ millions)	Rates of Change			
		Current Quarter	Current Year	Same Periods Previous Year	
		I/1985- II/1985	II/1984- II/1985	I/1984- II/1984	II/1983- II/1984
Selected Assets & Liabilities					
Total Loans & Leases	\$14,286	7.1%	12.7%	15.1%	16.1%
Commercial Loans	5,268	3.0	8.0	22.0	8.4
Consumer Loans	3,044	29.8	19.7	10.6	19.6
Real Estate Loans	2,973	2.4	10.7	10.8	10.2
Loans to Financial Institutions	930	-35.8	-11.0	41.2	3.5
All Other Loans	2,071	22.4	35.7	-4.5	80.4
Total Securities	3,458	23.5	2.5	2.0	NA
U.S. Treasury & Agency Securities	2,025	33.2	-3.3	-2.9	NA
Other Securities	1,431	11.4	12.1	10.8	NA
Total Deposits	17,272	2.9	6.7	7.8	8.1
Non-Transaction Balances	10,842	2.5	10.0	14.7	NA
MMDAs	2,124	-5.1	10.1	-0.1	4.0
\$100,000 CDs	3,730	-3.6	8.9	31.6	18.6
Demand Deposits	5,030	1.4	-1.2	-2.9	2.2
Other Transaction Balances ²	1,403	11.8	13.0	2.1	NA

SMALL WEEKLY REPORTING BANKS¹

	Level II/1985 (\$ millions)	Rates of Change		
		Current Quarter	Current Year	Previous Year
		I/1985- II/1985	II/1984- II/1985	I/1984- II/1984
Selected Assets & Liabilities				
Total Loans & Leases	\$4,496	10.6%	11.0%	18.5%
Commercial Loans	1,451	0.7	4.0	21.4
Consumer Loans	912	6.2	15.5	18.8
Real Estate Loans	1,784	18.0	18.5	16.7
All Other Loans	349	31.3	-2.7	14.1
U.S. Treasury & Agency Securities	1,712	7.8	4.5	15.4
Other Securities	651	-9.1	-2.0	-5.4
Total Deposits	7,025	12.9	8.6	8.1

¹ A sample of commercial banks with total assets greater than \$750 million. Historical data have been revised to incorporate adjustment factors that offset the cumulative effects of mergers and other changes involving weekly reporting banks during 1984. All data are not seasonally adjusted. Rates of change are compounded annual rates.

² Includes NOW, Super NOW, ATS and accounts permitting telephone or pre-authorized transfers.

³ A sample of commercial banks with total assets less than \$300 million as of January 1984.

EIGHTH DISTRICT BANKING DATA

Bank Performance Ratios¹

<u>RATIOS</u>	<u>I/1985</u>	<u>I/1984</u>	<u>I/1983</u>
Loans to Deposits			
Large Banks ⁴	79.93%	77.08%	72.65%
Small Banks ⁵	59.37	58.41	57.18
Loan Loss Reserves to Total Loans			
Large Banks	1.49	1.39	1.48
Small Banks	1.14	1.08	1.03
Delinquent Loans to Total Loans			
Large Banks	3.92	4.84	6.61
Small Banks	5.29	5.00	4.94
Net Loan Losses to Total Loans			
Large Banks	0.13	0.10	0.10
Small Banks	0.14	0.08	0.08

EIGHTH DISTRICT INTEREST RATES⁶

	<u>June 1985</u>	<u>May 1985</u>	<u>April 1985</u>	<u>Year Ago June 1984</u>
Super NOW	6.07%	6.36%	6.63%	7.54%
MMDAs	6.89	7.20	7.53	8.65
Time CDS				
92 — 182 days	7.45	7.74	8.27	10.37
1 — 2½ years	8.30	8.65	9.13	10.68
2½ years and over	8.66	8.95	9.40	10.82

⁴ All Eighth District banks with total assets greater than \$750 million. Ratios are derived from Call Reports.

⁵ All Eighth District banks with total assets less than \$300 million.

⁶ Average interest rates paid on new deposits by a sample of District commercial banks.