

# FRBSF WEEKLY LETTER

Number 91-27, July 26, 1991

## Real Estate Loan Problems in the West

Real estate loans have been a source of losses for banks in many areas of the country since before the recession began. Recently, Federal Deposit Insurance Corporation Chairman William Seidman raised concerns about problem real estate loans in California, which has focused attention on the quality of real estate loans at western banks, especially those headquartered in California.

In this *Letter* problem loan ratios are evaluated to gauge the severity of the recent deterioration in western banks' real estate loan portfolios, which include about half of all bank loans. Clearly, the problems experienced in the region reflect the impacts of the recession and the real estate slump. However, the evidence also suggests that asset quality deterioration has been less severe in the West than in the nation as a whole, and that current indicators are not out of line with those at the end of the last recession.

### Commercial real estate problems

Banks' equity capital and loan loss reserves provide a cushion against losses on real estate, commercial, and consumer loans and against the risk of earnings disruptions arising from asset quality problems. However, while banks nationwide have added about \$19 billion in equity capital and loan loss reserves since year-end 1989, their "problem" loans (defined as loans 30 days or more past due or no longer accruing interest) have increased by nearly double that amount.

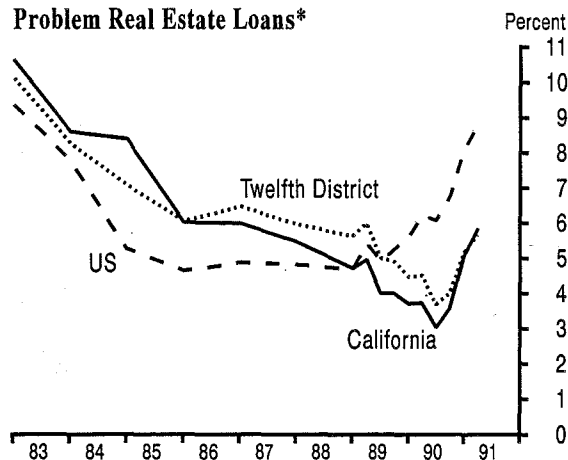
In the three quarters since June 1990, such problem real estate loans in the western region have nearly doubled as a percent of total real estate loans. Despite this increase, asset quality

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in the West, as measured by problem loan ratios, is still better than that reported by the industry as a whole. In March 1991 problem loan ratios were 5.66 and 5.82 percent for western and California banks, respectively, compared to 8.8 percent for the nation.

Furthermore, the historical time series for problem real estate loans at large banks (with over \$100 million in assets) shown in the chart also helps to put the current figures in perspective. Despite the upturn in problem real estate loans in the West after June 1990, problem loan ratios for the region also remain well below that experienced at the end of the last recession in 1982.

Problem Real Estate Loans\*



\*Annual data 1983-1988; quarterly data 1989-1991

The data for March 1991 for the first time also provide a breakdown of real estate loans by category for all banks. These data clearly indicate the

## WESTERN BANKING

Western Banking is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

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sources and magnitude of real estate loan problems. Nationally, only 3.2 percent of single family loans are reported as problem loans in March; in the western region, the number is even smaller—1.9 percent. Commercial real estate and construction loans, however, both in the nation and in the region, have deteriorated much more.

About 13 percent of all bank loans in the nation, or \$240 billion, are secured by commercial real estate. Western banks (\$43.7 billion) and California banks (\$30.7 billion) hold about the same share of their loan portfolio in commercial real estate loans as do banks nationally. In March, U.S. banks reported that 9.39 percent, or \$22.5 billion, of their commercial real estate loans were past due or on nonaccrual status. These ratios also are high in the region (6.75 percent) and in California (7.28 percent), but are still well below the industry average; these ratios are less than half the problem loan ratios reported in the depressed Northeast region.

Commercial real estate loan problems are likely to remain a major drag on asset quality and earnings, because overbuilding in this sector has resulted in high vacancy rates and falling rental rates in many markets. Salomon Brothers, for example, estimated that there is roughly an 11-year supply of commercial office space nationally. Thus many analysts expect that commercial real estate loans may continue to deteriorate even if the economy turns around quickly.

## Construction loan problems

Construction financing traditionally has been a relatively high risk activity, reflecting the nature of the construction industry itself. Nationally, banks' troubled loan figures for March bear this out. Problem construction loans, at \$22.8 billion, exceeded the amount of troubled commercial real estate loans, even though outstanding construction and land development lending for the U.S., at \$121 billion, is only half the level of commercial real estate lending.

Further deterioration in construction loan quality could have a disproportionate impact on banks' performance in the West, because construction lending is a larger part of banks' loan portfolios in this region than in the nation. In March 1991, construction lending accounted for 6.5 percent

of total loans for the U.S., 9.1 percent for the region, and 9.7 percent in California.

Still, western banks are reporting lower levels of problem construction loans than banks nationally. In March U.S. banks reported that 18.8 percent of their construction loans were problem loans, whereas banks in the region and California reported 13.4 and 14.2 percent, respectively. In contrast, New England banks reported problem loan ratios more than twice the ratio for California.

Given many analysts' prognoses for a weak recovery in construction and housing, and the likelihood that the high level of problem loans today may result in increased loan charge-off rates in the future, even the lower level of deterioration reported in this region will be a major challenge.

## Big picture

Clearly, banks in California and the West have experienced a significant increase in problem real estate loans since the onset of the recession. And, depending on the strength and timing of the recovery, nationally as well as in this region, problem loans could continue to rise until improved business conditions are reflected in the cash flows and on the balance sheets of banks' borrowers. Certainly, recent actions by several large western banks to boost loan loss reserves in the second quarter suggest that a recovery in asset quality will follow a normal pattern—lagging a turnaround in the economy, rather than moving with it.

Still, problem loan ratios suggest that real estate loan deterioration has been less severe in the West than in the nation as a whole or in the depressed northeastern states. And, by comparison to the end of the 1982 recession, real estate loan deterioration in this region has not been so severe. Thus, while California may now be an area of concern, at least through the first three quarters of the recession, real estate loans at the state's banks continued to outperform the nation.

**Gary C. Zimmerman**  
Economist

## REGIONAL BANK DATA

MARCH 31, 1991

(Not Seasonally Adjusted, Preliminary Data)

|  |                     | DISTRICT | ALASKA | ARIZONA | CALIF.  | HAWAII | IDAHO | NEVADA | OREGON | UTAH   | WASH.  |
|--|---------------------|----------|--------|---------|---------|--------|-------|--------|--------|--------|--------|
| <b>ASSETS AND LIABILITIES -- \$ MILLION (ALL COMMERCIAL BANKS)</b>             |                     |          |        |         |         |        |       |        |        |        |        |
| <b>ASSETS</b>  | <b>TOTAL</b>        | 497,723  | 4,348  | 33,855  | 341,677 | 17,945 | 8,938 | 14,753 | 25,202 | 11,862 | 39,144 |
|  | FOREIGN             | 37,956   | 1      | N/A     | 35,855  | 1,865  | N/A   | N/A    | 15     | 59     | 162    |
|  | DOMESTIC            | 459,767  | 4,347  | 33,855  | 305,822 | 16,080 | 8,938 | 14,753 | 25,187 | 11,803 | 38,982 |
| <b>LOANS</b>   | <b>TOTAL</b>        | 364,141  | 1,925  | 22,017  | 258,899 | 10,660 | 5,839 | 10,729 | 16,956 | 7,416  | 29,700 |
|  | FOREIGN             | 33,605   | 6      | N/A     | 32,163  | 1,293  | N/A   | N/A    | N/A    | N/A    | 142    |
|  | DOMESTIC            | 330,536  | 1,919  | 22,017  | 226,736 | 9,366  | 5,839 | 10,729 | 16,956 | 7,416  | 29,558 |
|  | REAL ESTATE         | 163,044  | 758    | 7,080   | 124,314 | 4,708  | 1,674 | 2,606  | 6,200  | 2,899  | 12,805 |
|  | COMMERCIAL          | 78,753   | 689    | 3,598   | 54,362  | 2,819  | 1,451 | 1,353  | 5,223  | 1,654  | 7,603  |
|  | CONSUMER            | 57,515   | 287    | 4,458   | 31,870  | 1,255  | 1,656 | 6,267  | 3,462  | 2,067  | 6,192  |
|  | AGRICULTURE         | 5,332    | 4      | 408     | 2,676   | 18     | 605   | 15     | 402    | 142    | 1,063  |
|  | INTERNATIONAL       | 179      | N/A    | 10      | 169     | 0      | N/A   | N/A    | N/A    | N/A    | 0      |
| <b>SECURITIES</b>  | <b>TOTAL</b>        | 44,479   | 1,849  | 4,351   | 21,602  | 3,884  | 1,738 | 1,798  | 3,318  | 2,373  | 3,567  |
|  | U.S.T.S.            | 12,723   | 929    | 1,299   | 5,939   | 1,362  | 393   | 556    | 651    | 471    | 1,122  |
|  | SECONDARY MARKET    | 20,382   | 455    | 1,893   | 10,588  | 1,637  | 873   | 640    | 1,676  | 1,355  | 1,266  |
|  | OTHER SEC.          | 11,374   | 465    | 1,159   | 5,075   | 884    | 472   | 602    | 991    | 547    | 1,179  |
| <b>LIABILITIES</b>   | <b>TOTAL</b>        | 464,465  | 3,834  | 31,431  | 319,807 | 16,857 | 8,347 | 13,585 | 23,219 | 11,049 | 36,336 |
|  | DOMESTIC            | 426,509  | 3,833  | 31,431  | 283,953 | 14,992 | 8,347 | 13,585 | 23,204 | 10,990 | 36,174 |
| <b>DEPOSITS</b>  | <b>TOTAL</b>        | 398,222  | 3,278  | 29,530  | 273,213 | 15,172 | 6,996 | 8,668  | 19,814 | 9,517  | 32,036 |
|  | FOREIGN             | 34,864   | 0      | N/A     | 32,865  | 1,681  | N/A   | N/A    | 2      | 59     | 256    |
|  | DOMESTIC            | 363,359  | 3,278  | 29,530  | 240,348 | 13,490 | 6,996 | 8,668  | 19,812 | 9,458  | 31,779 |
|  | DEMAND              | 77,063   | 874    | 4,541   | 54,946  | 2,185  | 1,182 | 1,956  | 3,158  | 1,668  | 6,552  |
|  | TIME AND SAVINGS    | 286,296  | 2,404  | 24,989  | 185,402 | 11,305 | 5,814 | 6,712  | 16,654 | 7,790  | 25,227 |
|  | NOW                 | 35,423   | 247    | 2,721   | 22,237  | 1,343  | 828   | 959    | 2,457  | 1,199  | 3,433  |
|  | MMDA                | 74,343   | 420    | 6,005   | 51,021  | 2,046  | 1,105 | 2,032  | 3,725  | 1,570  | 6,419  |
|  | SAVINGS             | 33,354   | 411    | 2,046   | 22,357  | 1,530  | 438   | 1,216  | 1,556  | 871    | 2,929  |
|  | SMALL TIME          | 86,114   | 722    | 12,096  | 47,606  | 1,819  | 2,798 | 1,389  | 7,001  | 3,337  | 9,347  |
|  | LARGE TIME          | 56,750   | 582    | 2,107   | 42,039  | 4,565  | 641   | 1,115  | 1,888  | 807    | 3,006  |
| <b>OTHER BORROWINGS</b>  |                     | 43,785   | 508    | 1,315   | 28,208  | 1,155  | 1,261 | 4,147  | 2,685  | 1,354  | 3,152  |
| <b>EQUITY CAPITAL</b>  |                     | 33,258   | 514    | 2,424   | 21,869  | 1,088  | 592   | 1,167  | 1,983  | 812    | 2,808  |
| <b>LOAN LOSS RESERVE</b>   |                     | 7,745    | 36     | 638     | 5,675   | 159    | 89    | 270    | 273    | 154    | 451    |
| <b>LOAN COMMITMENTS</b>  |                     | 194,429  | 543    | 11,999  | 143,792 | 5,692  | 2,139 | 2,114  | 9,523  | 3,043  | 15,583 |
| <b>LOANS SOLD</b>  |                     | 35,515   | 11     | 356     | 34,293  | 54     | 42    | 96     | 363    | 30     | 271    |
| <b>ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)</b>              |                     |          |        |         |         |        |       |        |        |        |        |
| <b>LOAN LOSS RESERVE (ALL BANKS)</b>   |                     | 2.13     | 1.88   | 2.90    | 2.19    | 1.49   | 1.52  | 2.51   | 1.61   | 2.07   | 1.52   |
| <b>NET CHARGEOFFS, TOTAL</b>   |                     | 1.21     | 0.08   | 1.25    | 1.29    | 0.07   | 0.38  | 3.27   | 1.00   | 1.11   | 0.48   |
|  | REAL ESTATE         | 0.36     | -0.04  | 1.30    | 0.32    | 0.01   | 0.05  | 0.03   | 0.52   | 0.68   | 0.37   |
|  | COMMERCIAL          | 0.71     | 0.00   | 1.79    | 0.60    | -0.00  | 0.49  | 4.93   | 1.24   | 1.80   | 0.32   |
|  | CONSUMER            | 2.57     | 0.66   | 1.91    | 2.95    | 0.52   | 0.69  | 4.41   | 1.35   | 1.63   | 1.09   |
|  | AGRICULTURE         | -0.28    | N/A    | 2.12    | -0.88   | -3.90  | 0.38  | -0.06  | 0.28   | 0.20   | -0.27  |
| <b>PAST DUE &amp; NON-ACCRUAL, TOTAL</b>                                       |                     | 5.41     | 5.46   | 5.97    | 5.83    | 1.52   | 1.90  | 8.78   | 3.33   | 4.30   | 3.57   |
|  | REAL ESTATE         | 5.66     | 5.16   | 10.40   | 5.82    | 1.42   | 2.10  | 3.51   | 4.00   | 6.39   | 4.62   |
|  | COMMERCIAL          | 6.52     | 7.10   | 13.50   | 7.03    | 2.06   | 1.98  | 8.42   | 3.76   | 4.46   | 3.04   |
|  | CONSUMER            | 3.88     | 2.81   | 1.67    | 3.49    | 2.25   | 1.63  | 11.40  | 1.66   | 2.47   | 2.20   |
|  | AGRICULTURE         | 6.74     | 34.80  | 9.85    | 7.87    | 9.92   | 3.56  | 1.19   | 5.17   | 3.78   | 4.73   |
| <b>EARNINGS AND RETURNS -- \$ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)</b> |                     |          |        |         |         |        |       |        |        |        |        |
| <b>INCOME</b>  | <b>TOTAL</b>        | 13,569   | 111    | 847     | 9,324   | 432    | 227   | 607    | 654    | 317    | 1,049  |
|  | INTEREST            | 11,280   | 95     | 673     | 7,795   | 387    | 200   | 441    | 540    | 271    | 878    |
|  | FEES & CHARGES      | 647      | 5      | 46      | 436     | 10     | 12    | 15     | 41     | 18     | 64     |
| <b>EXPENSES</b>  | <b>TOTAL</b>        | 11,732   | 89     | 826     | 8,086   | 355    | 189   | 478    | 550    | 276    | 883    |
|  | INTEREST            | 5,993    | 45     | 400     | 4,191   | 215    | 111   | 164    | 278    | 144    | 445    |
|  | SALARIES            | 2,241    | 22     | 165     | 1,553   | 70     | 30    | 53     | 116    | 44     | 188    |
|  | LOAN LOSS PROVISION | 838      | 2      | 60      | 555     | 9      | 5     | 98     | 44     | 21     | 43     |
|  | OTHER               | 2,661    | 20     | 200     | 1,788   | 60     | 43    | 163    | 112    | 67     | 207    |
| <b>INCOME BEFORE TAXES</b>   |                     | 1,830    | 22     | 21      | 1,230   | 78     | 38    | 130    | 104    | 41     | 166    |
| <b>TAXES</b>   |                     | 664      | 6      | -3      | 488     | 28     | 13    | 32     | 33     | 15     | 52     |
| <b>NET INCOME</b>  |                     | 1,165    | 16     | 24      | 741     | 50     | 25    | 98     | 72     | 26     | 114    |
| <b>ROA (%)</b>   |                     | 0.95     | 1.46   | 0.29    | 0.87    | 1.12   | 1.17  | 2.68   | 1.19   | 0.88   | 1.18   |
| <b>ROE (%)</b>   |                     | 14.0     | 12.3   | 3.96    | 13.5    | 18.3   | 17.1  | 33.5   | 14.4   | 12.8   | 16.2   |
| <b>NET INTEREST MARGIN (%)</b>   |                     | 4.29     | 4.61   | 3.34    | 4.24    | 3.88   | 4.09  | 7.60   | 4.39   | 4.29   | 4.48   |

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**MARKET SHARE STATISTICS**

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR MAY 1991, BY REGION

| DEPOSIT TYPE   | DISTRICT |    |    | ALASKA |    |    | ARIZONA |    |    | CALIF |    |    | HAWAII |    |    | IDAHO |    |    | NEVADA |    |    | OREGON |    |    | UTAH |    |    | WASH |    |    |
|----------------|----------|----|----|--------|----|----|---------|----|----|-------|----|----|--------|----|----|-------|----|----|--------|----|----|--------|----|----|------|----|----|------|----|----|
|                | CB       | SL | CU | CB     | SL | CU | CB      | SL | CU | CB    | SL | CU | CB     | SL | CU | CB    | SL | CU | CB     | SL | CU | CB     | SL | CU | CB   | SL | CU | CB   | SL | CU |
| TOTAL DEPOSITS | 52       | 43 | 5  | 73     | 4  | 23 | 89      | 5  | 6  | 46    | 50 | 4  | 69     | 28 | 3  | 87    | 9  | 4  | 70     | 26 | 4  | 82     | 12 | 7  | 78   | 8  | 14 | 56   | 36 | 8  |
| DEMAND         | 91       | 4  | 5  | 99     | 0  | 1  | 94      | 0  | 6  | 91    | 4  | 5  | 91     | 3  | 6  | 90    | 1  | 9  | 99     | 1  | 0  | 94     | 1  | 5  | 88   | 3  | 9  | 91   | 5  | 4  |
| NOW            | 64       | 29 | 7  | 59     | 6  | 35 | 88      | 3  | 9  | 59    | 35 | 6  | 72     | 27 | 2  | 88    | 8  | 3  | 77     | 15 | 9  | 85     | 8  | 7  | 84   | 3  | 13 | 65   | 23 | 12 |
| SAVINGS        | 51       | 32 | 17 | 37     | 3  | 61 | 71      | 3  | 26 | 49    | 39 | 13 | 53     | 38 | 9  | 78    | 11 | 11 | 66     | 17 | 17 | 60     | 20 | 20 | 58   | 5  | 37 | 44   | 20 | 36 |
| MMDA           | 65       | 33 | 2  | 89     | 8  | 2  | 95      | 4  | 1  | 60    | 38 | 2  | 80     | 20 | 0  | 94    | 6  | 0  | 82     | 16 | 2  | 91     | 5  | 4  | 82   | 6  | 12 | 68   | 30 | 2  |
| SMALL TIME     | 34       | 63 | 3  | 77     | 8  | 15 | 88      | 9  | 4  | 25    | 73 | 3  | 43     | 54 | 3  | 85    | 14 | 2  | 49     | 48 | 3  | 76     | 18 | 5  | 77   | 13 | 10 | 43   | 53 | 4  |
| LARGE TIME     | 47       | 49 | 3  | 94     | 3  | 3  | 91      | 3  | 6  | 42    | 54 | 3  | 82     | 17 | 1  | 85    | 10 | 5  | 66     | 33 | 0  | 89     | 8  | 3  | 82   | 9  | 9  | 47   | 52 | 1  |

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

**INTEREST RATES ON DEPOSITS AND LOANS AS OF MAY 1991 (%)**

| TYPE OF ACCOUNT OR LOAN           | DATE               | US    | DISTRICT | ARIZ  | CALIF | HAWAII | IDAHO | OREGON | UTAH  | WASH  |
|-----------------------------------|--------------------|-------|----------|-------|-------|--------|-------|--------|-------|-------|
| MONEY MARKET DEPOSIT ACCOUNTS     | MAR91              | 5.58  | 5.52     | 5.33  | 5.65  | 5.29   | 5.63  | 5.31   | 5.58  | 5.43  |
|                                   | APR91              | 5.46  | 5.41     | 5.17  | 5.55  | 5.29   | 5.61  | 5.25   | 5.52  | 5.30  |
|                                   | MAY91              | 5.33  | 5.28     | 5.05  | 5.33  | 5.13   | 5.56  | 5.11   | 5.56  | 5.29  |
| 92 TO 182 DAYS CERTIFICATES       | MAR91              | 6.28  | 5.99     | 5.61  | 6.10  | 5.90   | 5.94  | 6.13   | 5.88  | 6.36  |
|                                   | APR91              | 6.11  | 5.88     | 5.50  | 5.97  | 5.81   | 5.91  | 5.98   | 5.84  | 6.18  |
|                                   | MAY91              | 5.91  | 5.78     | 5.46  | 5.83  | 5.64   | 5.89  | 5.85   | 5.73  | 6.01  |
| 2-1/2 YEARS AND OVER CERTIFICATES | MAR91              | 7.04  | 6.66     | 6.30  | 6.83  | 6.95   | 7.03  | 6.68   | 6.73  | 6.91  |
|                                   | APR91              | 6.95  | 6.68     | 6.30  | 6.88  | 6.95   | 7.05  | 6.89   | 6.74  | 6.84  |
|                                   | MAY91              | 6.90  | 6.66     | 6.30  | 6.89  | 6.95   | 7.15  | 6.83   | 6.61  | 6.75  |
| COMMERCIAL, SHORT-TERM*           | AVE. RATE          | 7.75  | 8.54     | 9.43  | 8.64  | 8.50   | 9.09  | 8.55   | 8.18  | 8.11  |
|                                   | AVE. MAT. (DAYS)   | 47    | 153      | 167   | 188   | 162    | 135   | 102    | 78    | 118   |
| COMMERCIAL, LONG-TERM*            | AVE. RATE          | 9.24  | 9.02     | 10.27 | 8.99  | 10.51  | N/A   | 7.79   | 10.17 | N/A   |
|                                   | AVE. MAT. (MONTHS) | 40    | 43       | 37    | 43    | 53     | N/A   | 29     | 38    | N/A   |
| LOANS TO FARMERS*                 | AVE. RATE          | 9.84  | 8.67     | 8.74  | 8.63  | N/A    | 10.32 | 9.87   | 6.42  | 9.65  |
|                                   | AVE. MAT. (MONTHS) | 10    | 8        | 6     | 9     | N/A    | 11    | 12     | 6     | 8     |
| CONSUMER, AUTOMOBILE              | AVE. RATE          | 11.28 | 11.83    | 12.63 | 12.59 | N/A    | 12.00 | 10.74  | 11.00 | 10.95 |
| CONSUMER, PERSONAL                | AVE. RATE          | 15.16 | 15.14    | 16.50 | 19.27 | N/A    | 12.50 | 13.90  | 15.51 | 12.38 |
| CONSUMER, CREDIT CARDS            | AVE. RATE          | 18.22 | 18.50    | 18.00 | 18.82 | N/A    | N/A   | 19.24  | 19.48 | 17.97 |

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.

\* DATA ARE COMPOUNDED ANNUAL RATES.