

## Current Headlines – Taking a Deeper Dive

*Recently there has been a spate of headlines about household finances and the impact of commercial real estate on the banking sector. We aim to put some of these into proper context.*

BY MARK G. ROBERTS

Everyone from members of the media to market participants has been keeping a watchful eye on the U.S. economy, trying to decipher if a recession is imminent or avoidable. Recent negative headlines regarding household finances, bank loan activity, and the primary sectors of commercial real estate paint a bearish picture and might create concern for some investors. But the headlines are often alarmist, and the data used to support them can lack proper context or a balanced perspective. Digging deeper into the data reveals that there's more to the story.

*There are three types of lies:  
lies, damned lies, and statistics.*

“ ”

MARK TWAIN

### KEY HIGHLIGHTS

- Household debt has grown to record levels, but household assets have grown, too – and debt as a percentage of assets has fallen.
- Across all households, debt as a share of total assets is significantly lower compared to history.
- Given the strength of the fundamentals in apartments, industrial, and even retail, one can discount the risks in these sectors as implied in the headlines.
- The office market is challenged in certain buildings and locations. Yet even assuming a worst-case scenario of building values declining -50%, it implies loan losses of only 0.5% of banks' total assets.
- In the aggregate, the banking sector appears reasonably well capitalized and commercial real estate risks seem concentrated in certain regions and across certain classes of buildings in the office market.

PRESENTED BY

# Household Debt

Money Watch recently shared the following statistic about the record-setting level of household debt:

*Americans continue to pile up credit card debt, edging close to \$1 trillion... Counting all household debts, Americans owe a record \$17 trillion, the data shows.*

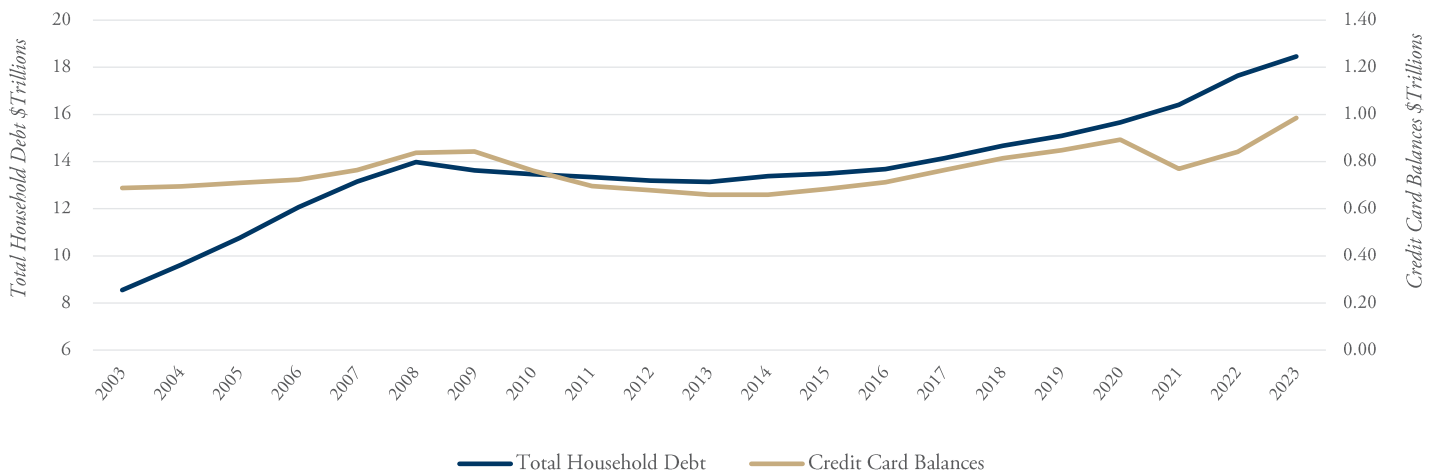
“ ”

CBS NEWS, MONEY WATCH | MAY 15, 2023

As Exhibit 1 indicates, both statements are true, but they lack context. With a growing population employing more people and a greater number of households each year, debt balances should continue to reach record highs every year absent a recession. Importantly, that's only one side of the household ledger. Missing in the headline: What was the growth in assets?

EXHIBIT 1

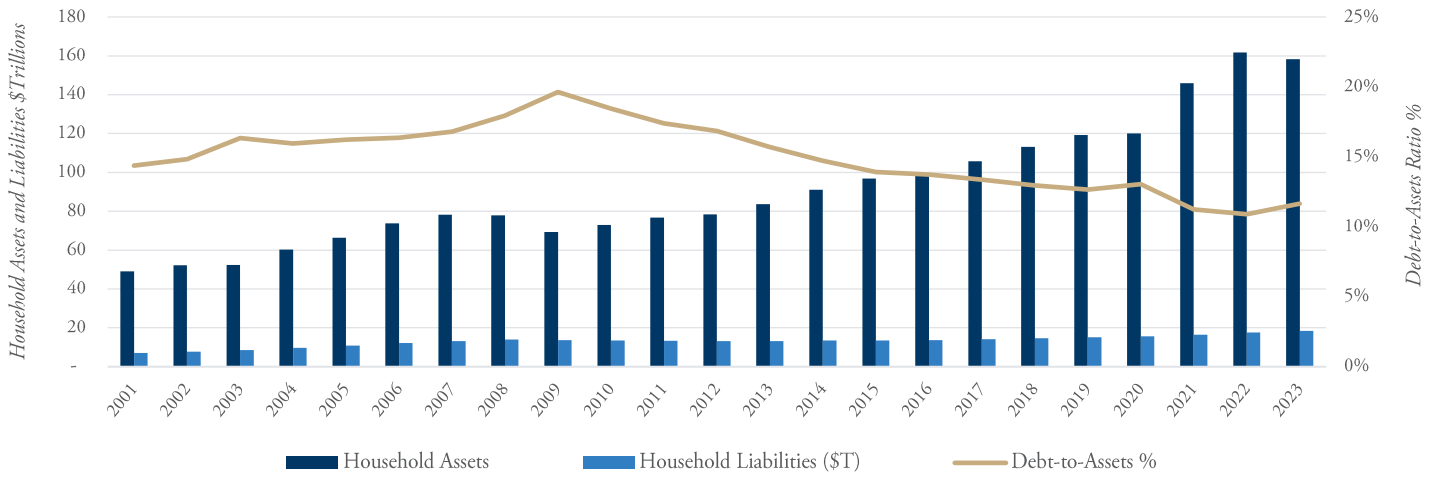
## Total Household Debt and Credit Card Balances, 1Q 2023<sup>1</sup>



Over the last 22 years, total household assets have grown an average of 5.5%, totaling nearly \$159 trillion at the end of 1Q 2023 (*Exhibit 2*). This is far greater than household debt of \$18.3 trillion, which grew at 4.5% annually. With household assets growing faster than household debt, debt as a percentage of assets has fallen. It was 14.4% in 2001. It rose to a worrisome amount of 19.6% amid the Global Financial Crisis in 2009 but has since fallen to 11.5%.

EXHIBIT 2

Household Debt and Assets and Debt-to-Assets Ratio, 1Q 2023<sup>2</sup>

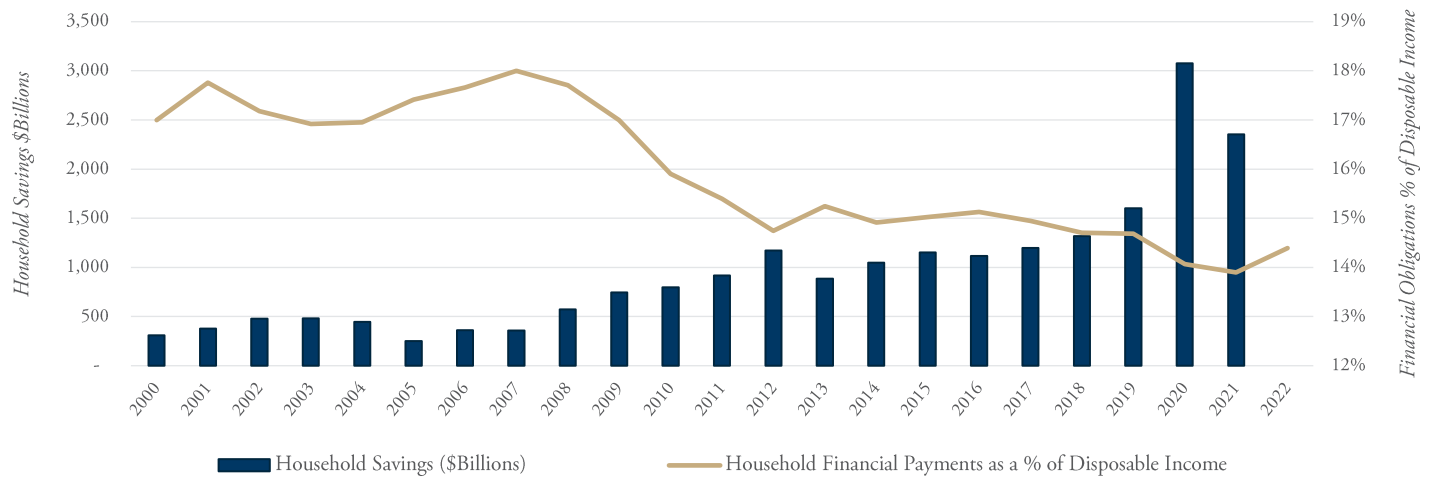


## Household Financial Obligations & Savings

One might also read about “record household debt” and draw a conclusion that household finances are in bad shape. The reality is very different. Households took advantage of low interest rates over the last decade and refinanced their debt, which not only reduced their debt service costs but also increased their savings. For example, household financial obligations as a share of disposable income fell from a peak of 18% in 2007 and currently stands at 14.4% (*Exhibit 3*).

EXHIBIT 3

Household Savings & Payments<sup>3</sup>



As for savings, households were building back their savings even before the COVID-19 stimulus packages. At the start of the GFC in 2008, households had a little more than \$500 billion in savings. That amount tripled to a little more than \$1.5 trillion by year-end 2019, it doubled again to more than \$3 trillion during COVID-19, and it has since fallen back to \$2.4 trillion.

Some might argue that total household savings grew because the number of households grew. That’s partially true, as the number of households grew 0.8% annually from 2008 to 2021 and total savings increased 11.5% per year. Still, savings per household increased 10.6% per year. Even excluding the “COVID-19” years, savings per household grew 8.8% per year.

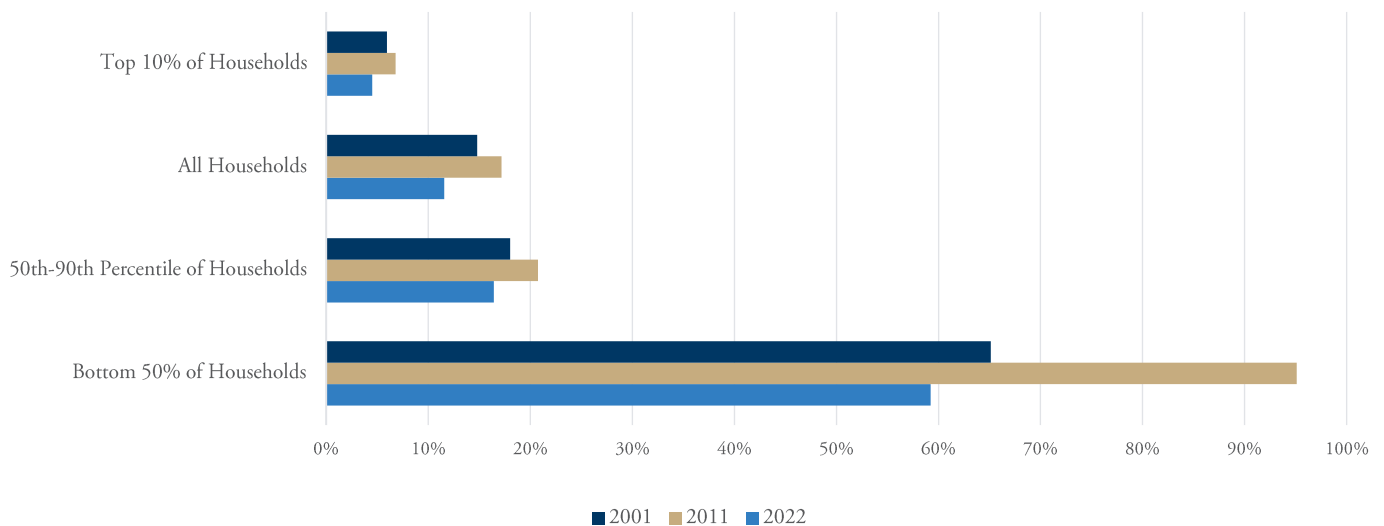
## Household Debt-to-Assets Across Households & Credit

While debt-to-assets of all households combined is near a 20-year low at 11.5%, that figure skews the distribution. Using data from the Federal Reserve, we can break out household debt and assets and determine that, across all households, debt as a share of total assets is significantly lower compared to history.

As seen in Exhibit 4, the debt-to-assets ratio of the bottom 50% of households in the U.S. reached a peak of 95% in 2Q 2011 but it declined to 59% by the end of 1Q 2023. Since 2011, household assets for the bottom 50% increased 6% per year while their household debt grew at a slower pace of 1.8% per year. As a result, the net worth for the bottom 50% of households increased from \$280 billion to over \$4 trillion.

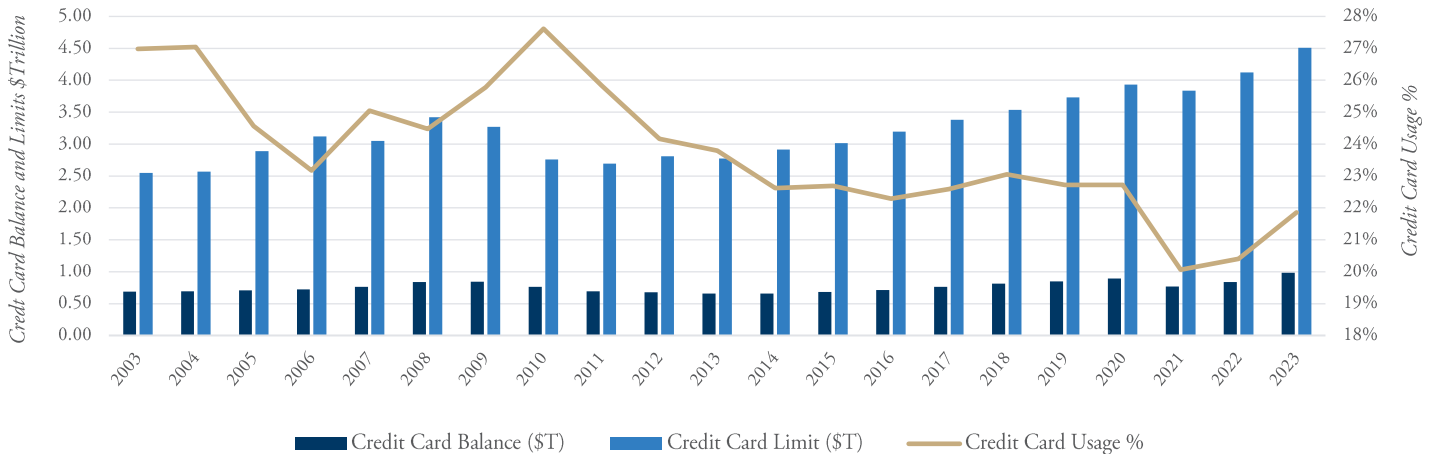
EXHIBIT 4

### Distribution of Household Debt as a Percent of Household Assets Across Households<sup>4</sup>



Finally, as household net worth increased, household creditworthiness has increased as well. So, while “Americans continue to pile up credit card debt,” credit card companies continue to increase credit limits, which recently reached \$4.5 trillion (*Exhibit 5*). However, households are not tapping their credit lines to the extent they did leading up to the GFC and credit card usage has fallen from more than 27% to 22% of total credit card limits.

EXHIBIT 5  
Credit Card Balances & Limits<sup>5</sup>



## Real Estate Market Conditions and Banking Sector Risks

During the first quarter of this year, a lack of liquidity amongst a few regional banks took center stage over inflation. Since then, some attention has shifted away from depositor withdrawals to the commercial real estate loans that banks hold and the risks those may represent. A couple of headlines from the *Financial Times* and NPR underscore the sentiment in some parts of the media:

*U.S. lenders warned that commercial property is ‘next shoe to drop.’*

“ ”

FINANCIAL TIMES | MAY 8, 2023

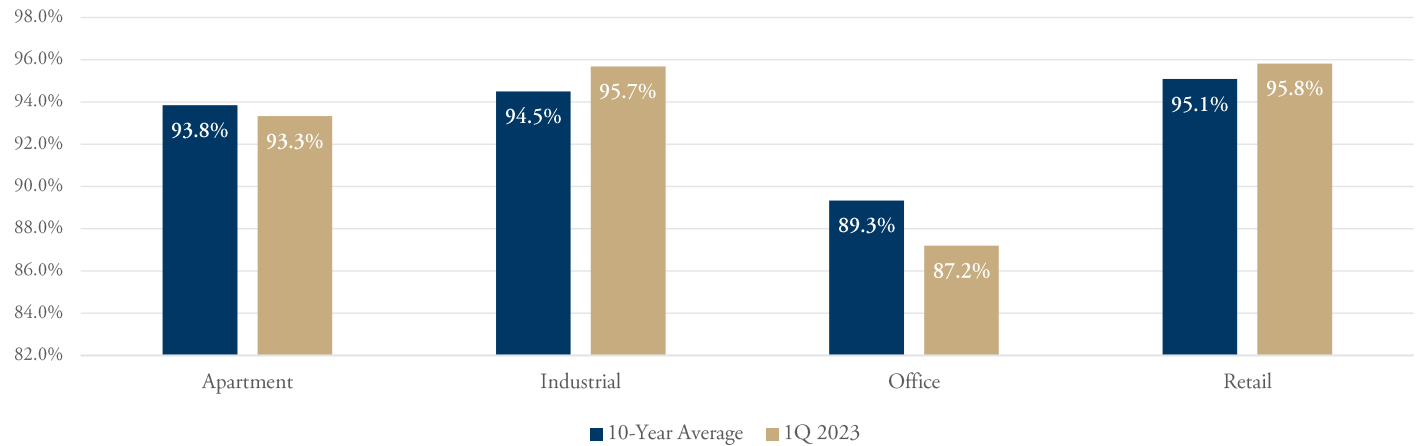
*All these empty offices pose a threat to the economy. An unraveling of the office sector spells troubles...for banks who are owed an estimated \$1.2 trillion in outstanding office loan debt...*

“ ”

NPR | MAY 16, 2023

As the pandemic unfolded, there was a tsunami of tenant demand for apartments and warehouse space. With supply-chain issues and low unemployment, developers struggled to deliver the supply needed to meet this surge of demand. Conversely, because office and retail tenant demand was weak, developers held back on new construction of office and retail buildings.

## EXHIBIT 6

**Occupancy Rates by Major Property Sector: 1Q 2023 vs. Average of 1Q 2013 – 1Q 2023<sup>6</sup>**

Given the strength of the fundamentals in apartments, industrial, and even retail, one may be able to discount the risks in these sectors as implied in the headlines. Occupancy rates for apartments, industrial, and retail buildings were near or above their trailing 10-year average at the end of 1Q 2023 per CoStar (*Exhibit 6*). Of the largest 34 apartment markets, the occupancy rate ranged from a low of 90% in Nashville to a high of 97.6% in New York. Given the current level of occupancy, one should expect rent growth to range from a low of -2% for the weakest markets to 6.5% for the stronger markets.

The industrial market continues to defy expectations. Nationally, occupancy rates are 1.2% higher than the trailing 10-year average and range from a low of 92.8% in San Francisco to a high of 98.1% in Miami. Except for two markets – Denver and San Francisco – the largest markets are posting occupancy rates that are higher than their long-term average. As a result, one could expect rents are likely to grow at least 3% to 4% if not more over the next year.

Since COVID-19 subsided, shoppers and tenants have returned to the stores. Nationally, retail occupancy rates were 95.8% at the end of 1Q 2023, which was 0.7% higher than the 10-year average of 95.1%. Across the 34 largest retail markets, occupancy rates ranged from a low of 94.5% in San Francisco to a high of 97.8% in Raleigh.

## Unmasking the Office Sector

Working from home has unsurprisingly taken its toll on the office market. And, more recently, some have suggested the risks in the office sector are concentrated in Class B and Class C assets versus Class A office assets. Quoting a recent article from CNBC<sup>7</sup>:

*Higher vacancies mean some buildings are worth less ... that's especially true for older, so-called Class B buildings that are losing out to newer buildings as tenants renew leases.*

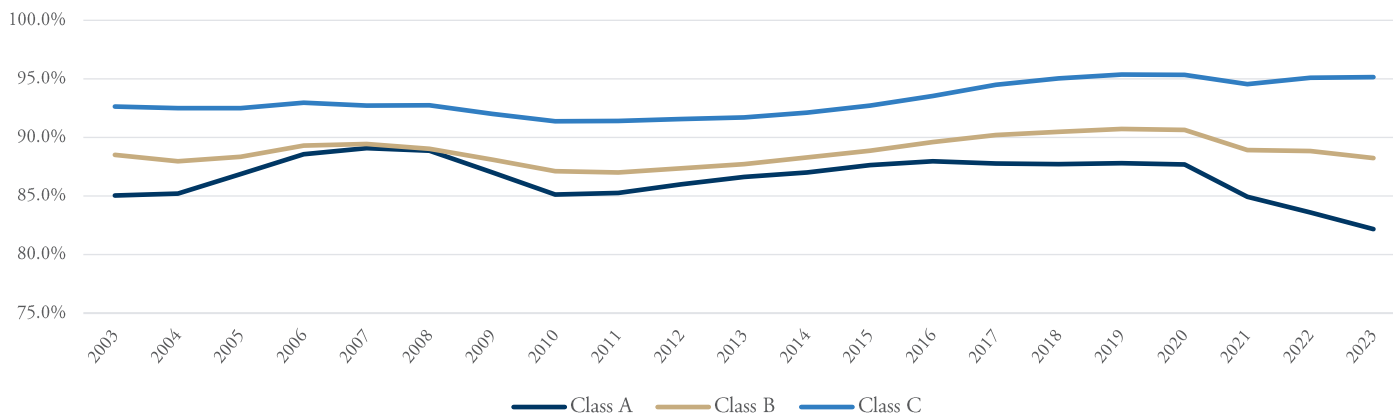
“ ”

CNBC | APRIL 9, 2023

At the end of 1Q 2023, CoStar reported the national occupancy rate was 87.2%, or 2.1% lower than the long-term average of 89.3%. Delving deeper though, and perhaps counterintuitively, Class B and Class C buildings seem to have higher occupancy rates than Class A buildings. At the end of 1Q 2023, Class A occupancy rates nationally were 82.2% versus Class B at 88.2% or Class C at 95%. Occupancy rates for Class B buildings trailed its trailing 10-year average by only 1% while Class C buildings had an occupancy rate that was 1% higher than its 10-year average. In contrast, Class A occupancy rates were about 4% below their 10-year average.

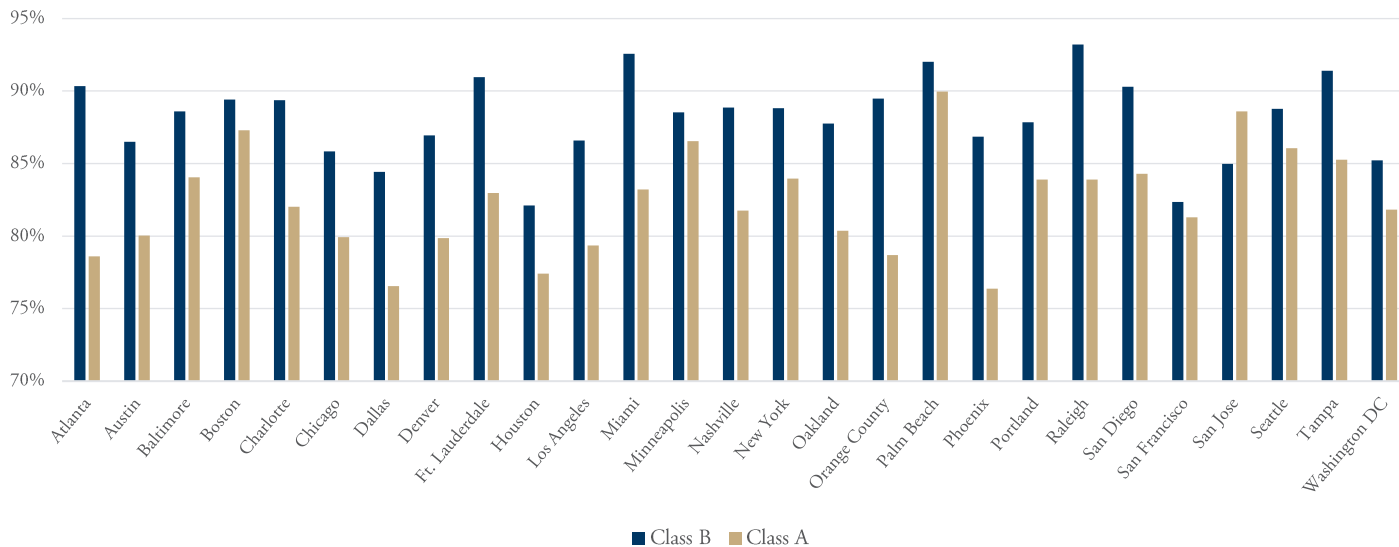
EXHIBIT 7

Office Occupancy Rates for Class A, B & C Buildings: 1Q 2003 – 1Q 2023<sup>8</sup>



Also, the trend continued across markets with Class B occupancy rates exceeding Class A occupancy rates (*Exhibit 8*) except for San Jose, where Class A occupancy rates exceed Class B. This analysis calls into question the conventional wisdom that Class A buildings are performing better than other classes of buildings. It's beyond the scope of this article, but admittedly, the credit quality and performance of Class A could be better than class B, which could support more stable values in Class A versus Class B buildings.

EXHIBIT 8  
Office Occupancy Rates Class A vs Class B Buildings by City, 1Q 2023<sup>9</sup>



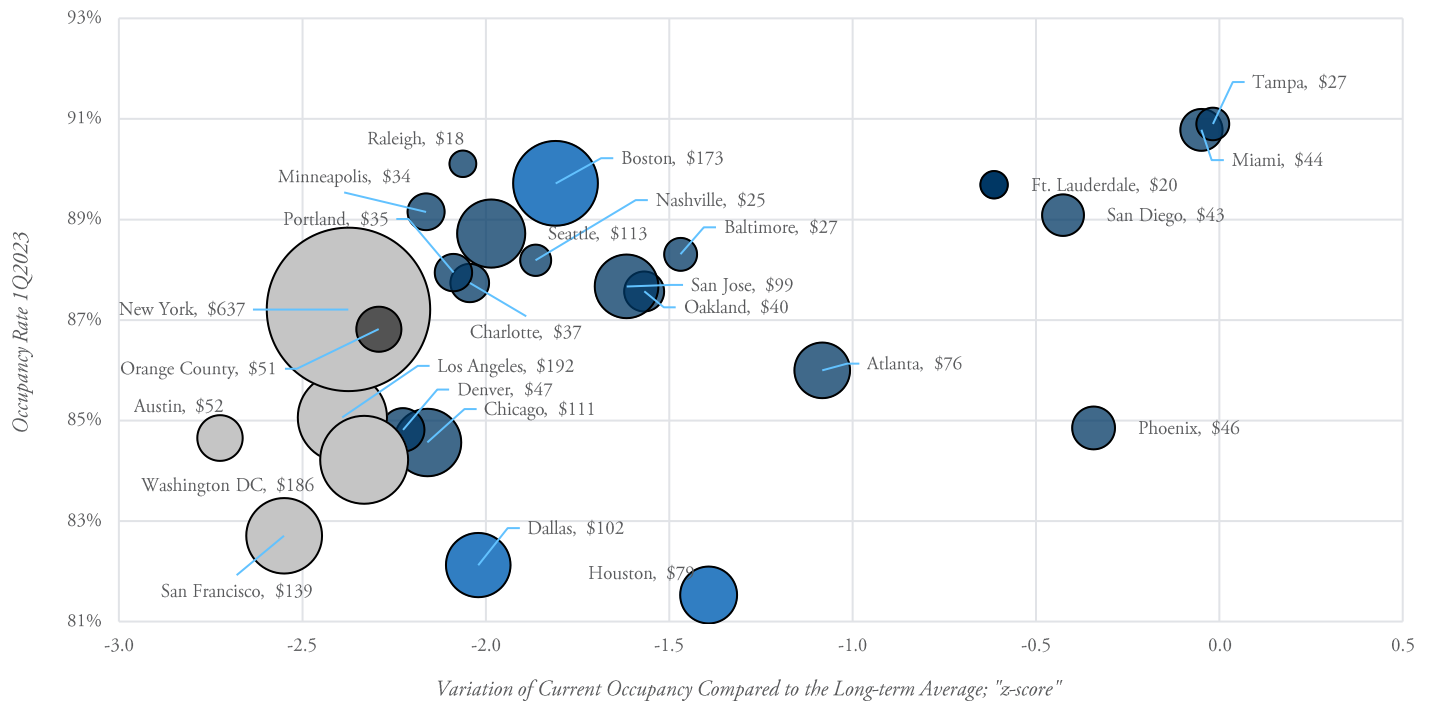
For example, tenant demand growth for Class A buildings has been higher, averaging 1.5% per year over the last 20 years, compared to all sectors combined, which grew 0.8% per year. The top-tier subset of Class A space that CoStar refers to as “Five Star” buildings and comprises 6% of office space in the U.S. has seen even greater tenant demand growth, averaging 4.1% over the last 20 years. Nevertheless, the office market is under pressure, but closer inspection reveals the market is bifurcated and there may be risks in certain markets and opportunities in others.

Namely, recent headlines have described distressed sales of a few office buildings in New York and San Francisco. These are two of the largest office markets in the U.S. with arguably some of the weakest office fundamentals. Using CoStar’s inventory and market value per square foot data, the value of the office market as of 1Q 2023 in New York was \$637 billion and \$139 billion in San Francisco.

Over the last 10 years, the occupancy rate for all classes of buildings in New York averaged 90.7% and varied from the average in any given year by 1.5%. At the end of 1Q 2023, the occupancy rate equaled 87%. While that doesn’t seem low, the difference between the current occupancy rate and its long-term average varies 2.4 times more than what is normal.<sup>10</sup>



EXHIBIT 9

**Office Market Size by Market in \$Billions vs. Current Occupancy and Variation in Occupancy<sup>11</sup>**

While the size of San Francisco office market is only 20% of the size of the New York office market, San Francisco's fundamentals are weaker than New York's. The current occupancy rate is only 82.7% and well below its 10-year average of 91.4% and 2.5 times more than what is normal. As a result, rents in both markets could fall by an average of -8% to -10% or more per year until tenant demand improves and the occupancy rate increases.

Other markets that exhibit similar weaknesses are Los Angeles, Orange County, Washington D.C., and Austin. In the case of Dallas, Houston, and Atlanta, these markets typically post a lower long-term average occupancy rate. Thus, the current occupancy rate varies less in these markets compared to the others mentioned. In contrast, the office markets in Florida, Phoenix, and San Diego are currently on better footing and posting occupancy rates closer to their longer-term average.

Returning to the question of the banking sector and the risk of commercial real estate loans, this analysis highlights the concentration and bifurcation across the U.S. and why many regional banks may fare better than others. To add a finer point, the six weakest markets noted accounted for 40% of the market value of the cities shown in Exhibit 9. But let's consider a worst-case scenario for the banking sector.

At the end of April 2023, banks held \$1.7 trillion of non-farm non-residential loans as assets on their balance sheet, which represented 7.4% of their \$23 trillion in total assets.<sup>12</sup> Of this amount, banks held roughly \$700 billion in office and downtown retail loans, as reported in the Federal Reserve's Financial Stability Report.<sup>13</sup>

Let's assume these loans had a 60% loan-to-value ratio at origination and assume a worst-case scenario that those buildings have lost 50% of their value. By way of comparison, office building values declined -34% during the GFC.<sup>14</sup> Even still, if office building values declined -50%, it implies banks could be exposed to loan losses of \$115 billion or less. That amount represents 0.50% of assets and would lower the Tier 1 ratio by a fractional amount from their current level of 14.5%.<sup>15</sup>

Looking at the subset of smaller banks,<sup>16</sup> they held \$620 billion in commercial real estate loans against assets of \$14.2 trillion. Applying the same assumptions, these smaller banks could be exposed to about \$100 billion in losses, representing a fractional amount of 0.70% of their total assets.

To close, there are bound to be certain overleveraged and underutilized assets, which will encounter challenges and may provide some headline risk. In the aggregate, the banking sector appears reasonably well capitalized and commercial real estate risks seem concentrated in certain regions and across certain classes of buildings in the office market. And while the office sector poses challenges, the other major property sectors seem to pose less of a risk.

Fortunately, household balance sheets are in great shape, the U.S. has low unemployment, and the economy has seen stable employment growth. Despite the rapid rise in interest rates, we have a growing economy with higher employment and less new construction. Taken together, this underpins fundamentals in the real estate market. So, while the headlines around real estate may drive some investors away and result in less liquidity, these dynamics could lead to higher risk premiums and better investment opportunities for overlooked assets in markets and sectors exhibiting stronger fundamentals.



## ABOUT THE AUTHOR

---

### Mark G. Roberts

*Managing Director of Research*  
Crow Holdings

Mark G. Roberts is Managing Director of Research at Crow Holdings, where his primary responsibilities include the development of insights, market research, and commentary on real estate topics of interest to investors, developers, operators, and other industry participants. Mark's position is shared with the Robert and Margaret Folsom Institute for Real Estate at SMU Cox School of Business, where he extends his expertise into the classroom, teaching market analysis and strategy to undergraduate and graduate students.

Mark, a fellow at the Real Estate Research Institute, a regular contributor to the National Council of Real Estate Investment Fiduciaries, and a registered architect, has over 30 years of real estate experience. He recently served as Executive Director of the Real Estate Center at the UT Austin's McCombs School of Business, and he previously served as a Managing Director at DWS Real Estate, where he held several senior leadership positions including Head of Research & Strategy, Alternatives and Real Assets, Head of U.S. Multi-asset & Solutions, and Co-Head of Research.

Prior to joining DWS's Real Estate in 2011, he served as Global Head of Research at Invesco Real Estate, a division of Invesco Asset Management Limited. Mark was the Chairman of the Board of NCREIF, President of RERI, Chairman of the NCREIF Research Committee, and a member of the NCREIF Fund-Index Subcommittee, which developed the NFI-ODCE Index. He initiated and served on the Leadership Committee of the Global Real Estate Fund Index, which is a joint effort of NCREIF (US), INREV (Europe), and ANREV (Asia-Pacific).

Mark holds a Master of Science in Real Estate from the Massachusetts Institute of Technology and a Bachelor of Arts in Architecture from the University of Illinois at Urbana.

## ABOUT CROW HOLDINGS

Crow Holdings is a leading real estate investment and development firm founded in 1948 and based in Dallas, Texas. With 20 offices across the U.S., Crow Holdings' local, on-the-ground presence amplifies its hands-on capabilities across a broad range of investment strategies, product types, and ventures in partnership with institutional investors. Crow Holdings has \$29 billion in assets under management, one of the largest multifamily and industrial development platforms in the nation, investments across the energy sector including solar and battery storage projects, and a broad, diversified investment portfolio, pursuing compelling investment opportunities to capitalize on evolving, secular growth potential. For 75 years, Crow Holdings' success has been rooted in its founding principles of partnership, collaboration, and alignment of interests.

## ABOUT SMU FOLSOM INSTITUTE FOR REAL ESTATE

The Margaret and Robert Folsom Institute was established at the SMU Cox School of Business in 1984 through a generous gift from former Dallas mayor and real estate developer Robert Folsom. It has been the backbone of real estate activity at SMU, supporting research and the real estate academic programs at both the BBA and MBA levels. The Institute is cultivating tomorrow's real estate leaders through its dedication to academic excellence, applied learning, thought leadership, and career development.

## Disclaimer & Footnotes

### Disclaimer

The commentary reflects the thoughts of the author as of June 14, 2023. This information has been provided by Crow Holdings. All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment-making decision. The views and opinions expressed are those of the author at the time of publication and are subject to change. There is no guarantee that these views will come to pass.

### Footnotes

1. Crow Holdings Research & Strategy using data from Bloomberg and the Flow of Funds data from the Federal Reserve for household debt and NY Federal Reserve & Equifax for credit card balances, as of 1Q 2023, reflecting the latest data available. Data shown is for the first quarter of each year.
2. Crow Holdings Research & Strategy using data from Bloomberg and the Flow of Funds data from the Federal Reserve for household debt and assets. Author's calculation for the debt-to-assets ratio. Data shown for the first quarter of each year as of 1Q 2023 and reflects the latest data available.
3. Crow Holdings Research & Strategy using data from the Federal Reserve "FRED" database for Household Financial Obligations as a Percent of Disposable Personal Income as of 1Q 2023. Household Savings is from the U.S. Bureau of Economic Analysis. The data for household savings is released annually and the most recent reporting period of 2021 is shown.
4. Crow Holdings Research & Strategy using data from Bloomberg and the Flow of Funds data from the Federal Reserve, Table B.101.h for household, assets, liabilities, and net worth. Debt-to-assets ratio calculated by the author using the latest data available, 4Q 2022.
5. Crow Holdings Research & Strategy using data from NY Federal Reserve & Equifax, "Quarterly Report on Household Debt and Credit", May 2023. Data shown is for the first quarter of each year. Calculations for credit usage by author and representing the ratio of credit card balances to credit card limits.
6. Crow Holdings Research & Strategy using data from CoStar for the U.S., as of 1Q 2023. 10-year average calculations by the author.
7. "The coming commercial real estate crash that may never happen", CNBC April 9, 2023.
8. Crow Holdings Research & Strategy using data from CoStar for the U.S. office market, as of 1Q 2023. Data shown is for the first quarter of each year.
9. Crow Holdings Research & Strategy using data from CoStar for the largest U.S. office market, as of 1Q 2023.
10. Statisticians refer to this as a "z-score." In the exhibit, it measures the difference between the current occupancy rate and the 10-year average occupancy rate divided by the variation, or standard deviation, of the occupancy rate over the 10-years from 1Q 2013 – 1Q 2023. Because all cities have a different long-term average occupancy rate, using a z-score serves to normalize these differences and compare each market equally to their long-term average occupancy rate.
11. Crow Holdings Research & Strategy using data from CoStar. The market size was calculated by the author using the current inventory and market value per square foot as of 1Q 2023. The occupancy rate on the vertical scale is as of 1Q 2023. The variation in occupancy on the horizontal scale represents the "z-score". Please see footnote #10 for a description of the "z-score."
12. Bloomberg using data from the Federal Reserve, April 26, 2023.
13. Federal Reserve Board, "Financial Stability Report," May 2023, page 17.
14. NCREIF Office Property Appreciation Index. Values peaked at an index level of 170.8 in 1Q2008 and reached a trough of 112.3 in 1Q 2010, for a total decline of -32.4%.
15. International Monetary Fund, September 30, 2022.
16. Smaller banks are those defined as non-Category I banks as described in the Federal Reserve's Financial Stability Report, May 2023.