

## Commercial Real Estate Concentration Levels in U.S. Banks

A.M. Best has initiated analysis and coverage of the U.S. banking industry. This article is the latest installment in a regular

series of research papers and analytical methodologies that highlight trends in the [U.S. banking industry](#).

A significant number of U.S. banks may find their commercial real estate lending activities under increased regulatory scrutiny if the proposed Inter-Agency Guidance on Concentrations in Commercial Real Estate Lending is implemented. The proposed guidance establishes two thresholds in relation to total capital (defined as total risk-based capital) to measure commercial real estate loan exposure levels. The first threshold, which measures the level of construction lending, is set at 100% of capital, while the second, which is a measure of construction, multifamily, and commercial real estate lending activity, is set at 300% of capital. Banks that exceed one or both of these levels will be considered to have a concentration in that particular type of lending activity and may require enhanced risk-management practices. In some cases, additional capital may be needed to support the risk within a particular segment of the loan portfolio.

A review of the Dec. 31, 2005, bank regulatory filings indicated that 1,956, or 22.1%, of the 8,832 Federal Deposit Insurance Corp.-insured financial institutions had construction-loan-to-total-capital ratios that exceeded the 100% threshold (see Chart 1). Of those banks that exceeded the 100% threshold, there were 24 institutions whose exposure was more than 500% of total capital, with the top bank's concentration level approaching 750% of total capital (see Table 1). Nine of the 24 banks are headquartered in Georgia, while three more are based in Florida. In addition, 198 of the 349, or 56.7%, of Georgia-based banks had concentrations that exceeded the 100% threshold. The numbers were similar for Florida, as 153 of its 300 banks (51%) had concentra-

tion levels above the 100% threshold. These two states, which had the highest numbers of banks exceeding the 100% threshold, accounted for nearly 18% of the 1,956 banks with construction lending concentrations.

At Dec. 31, 2005, there were 2,593 institutions (29.4% of insured banks) whose total commercial real estate lending exposure exceeded the 300% threshold (see Chart 2). Included in this number were 20 banks whose exposure was more than 800% of total capital, with the highest concentration level surpassing 1,030% of total capital (see Table 1). Out of these 20 banks, 14 are headquartered in California, while two are based in New York. The remaining four banks each are based in different states. Total commercial real estate lending concentrations were relatively high in California banks, as 192 of its 303 banks (63.4%) had levels above the 300% threshold. Notably, only Georgia and Florida had more banks, 200 and 196, respectively, with exposure levels above the 300% threshold.

While the proposed guidance indicates that loans secured by "owner-occupied" properties are excluded from the definition

Table 1

### Top Five Banks with the Highest Commercial Real Estate Concentration Levels at 12/31/05

100% Threshold		300% Threshold	
Bank Name, State	Actual %	Bank Name, State	Actual %
K Bank, MD	747.1%	Mesa Bank, AZ	1,033.9%
Prime Alliance Bank, UT	669.8%	Pacific Premier Bank, CA	1,026.8%
Mesa Bank, AZ	658.6%	Luther Burbank Savings, CA	1,005.3%
Butler Bank, A Co-op Bank, MA	643.0%	Malaga Bank, F.S.B., CA	941.9%
Golf Savings Bank, WA	624.9%	Sonoma National Bank, CA	935.3%

Source: Federal Deposit Insurance Corp.

Rankings were calculated using the methodology described in the proposed Inter-Agency Guidance on Concentrations in Commercial Real Estate Lending which was published for comment in the Federal Register on Jan. 13, 2006.

*This report was written by Steven Wollum, CFA financial analyst with A.M. Best Co.*

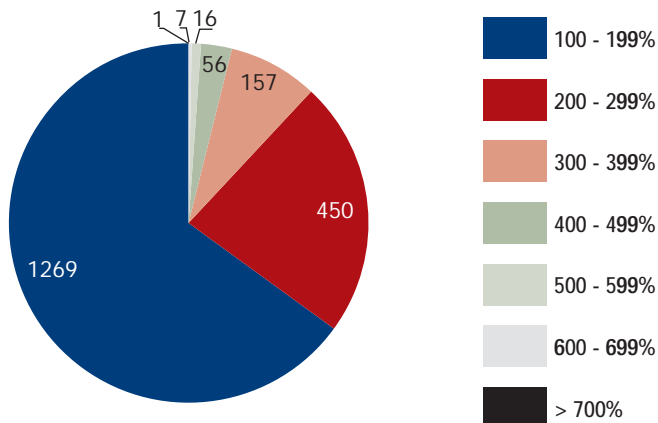


of commercial real estate, information about such properties is not available from the regulatory filings that formed the basis for this analysis. However, even without this

Chart 1

### Number of Banks Exceeding 100% Threshold of Construction Loans to Total Capital as of 12/31/05

(Percentage Ranges - 1,956 Total Banks)

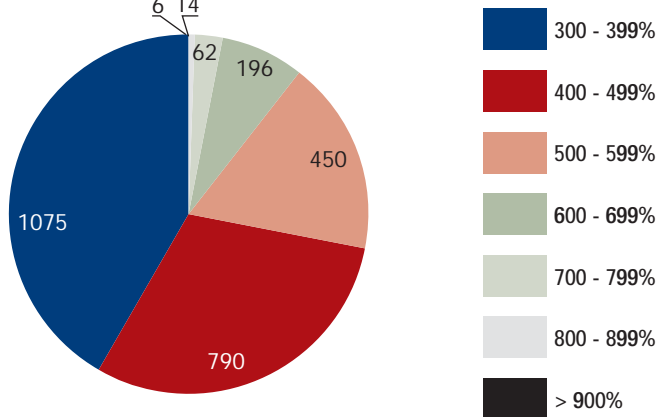


Source: FDIC

Chart 2

### Number of Banks Exceeding 300% Threshold Of Commercial Real Estate Loans to Total Capital As of 12/31/05

(Percentage Ranges - 2,593 Total Banks)



Source: FDIC

information, these rankings still provide a good starting point for determining which institutions and regions of the country may be most susceptible to a downturn in the commercial real estate market.

A.M. Best will continue to monitor this issue and will comment as future developments warrant.

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