

## **ECB BMCG**

## CRE impact on bond markets

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### Investment funds are more exposed than banks in the European commercial real estate

COMMERCIAL REAL ESTATE LOANS AS % OF ALL LOANS, CRE NPL AS % OF ALL NPL LOANS & CRE COVERAGE RATIOS



Sources: AEW Research & Strategy, European Banking Authority & Natixis Research as of year-end 2022

#### CRE market transactions by buyer type and origin - 2015-2019



• Bank direct CRE loans are about 5% to 7% of outstanding loans. The IMF estimates that *CRE-related debt is nearly 12 percent in Europe and 18 percent in the US.* 

- Country divergence: Germany more exposed than France or Spain. LTVs are the lowest in France, Spain and Germany and the highest in Finland, Ireland and Italy.
- Local and CRE specialised lenders more exposed than the larger banks. CRE loans used as collateral; indirect exposure means credit conditions with lower CRE prices.
- The ECB calculates: 16% of loans exposed to CRE by purpose and collateral. A further 12% of loans use CRE as collateral for non-CRE loans.
- The ESRB defines a "CRE loan" as a loan whose purpose or collateral is associated with CRE. 25% of NFC loans were exposed to CRE through the credit risk channel.
- Investment funds higher direct exposure than banks, accounting for for 58% of CRE purchases between 2015-19.



Sources: ECB calculations and AnaCredit

Notes: A loan is considered to be CRE-purposed if it is flagged as a CRE purchase, an RRE purchase or a construction purchase. A loan is considered to be CRE collateralised if its collateral is flagged as CRE, RRE or Offices and commercial premises. It should be borne in mind that RRE purchased by non-households is considered to be a CRE purchase (see <u>lead article</u>).

Source: Real Capital Analytics (RCA)

# CRE prices are pointing to further NPL rise ahead. Vacancy rates, maturity profile and size of market better in Europe than in the US.

Maturing debt

#### EZ CRE Price & German Real Estate NPL Ratio

Euro Area CRE Price Index (inverted, lag 2q) (LHS)
Germany NPL Ratios of NFC Real Estate Loans (RHS)



25% Pre-Covid 21% 20% 16% 13% 15% 15% 10% 10% 8% 10% 5% 5% 0% 3**0**15 2Q16 3Q18 2Q19 4Q05 3006 2007 80 408 80 3009 2010 3012 2013 1014 **t**04 1020 020 1023 1023 1017 4017 <u>8</u>21 ē 202 ġ Globa North America Europe Asia Pacific

Office Vacancy Rate (%)

Source: JLL Research, January 2024. Note: Data based on 65 markets in the U.S. and Canada; 23 markets in Europe; 25 markets in Asia Pacific

#### **Real Estate NPL Ratios**



4. Estimated Maturing CRE Debt and Debt Funding Gap



→ Spain (LHS) → Italy (RHS) → EU (LHS) → France (LHS) → Netherlands (LHS) → Germany (LHS)

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### Covered bonds widened with CRE exposed banks, but overall bank credit spreads stable

#### **Covered Bonds & Bank Funding Costs**





Source: Macrobond, Bloomberg

#### **Covered Bonds & PBB**



- Deutsche Pfandbriefbank (inverted) (LHS) - Coverd Bonds Swap spread (RHS)

- Covered bond swaps spreads have widened, with some of the widening coinciding with CRE exposure fears.
- Bank credit spreads have not followed wider, not showing general market stress.
- Covered bonds asset pool mostly residential loans, not commercial real estate.
- Investors potentially limited by internal risk limits, which can be temporary.
- Some signs of investors running to safety when CRE fears spike, but other factors likely to be more meaningful drivers for ASW.

#### PBB & Asset Swap Spread (weekly changes)

-Schatz ASW (RHS) - Deutsche Pfandbriefbank AG (LHS)



Source: Macrobond, Bloomberg

## Topics for discussion

- CRE indirect exposures via the collateral channel to hinder banks' lending willingness?
- CRE risks limiting investors' appetite or risk limits in investing in covered or bank bonds?
- Risks from CRE contagion and a run to safe haven assets?