The COVID-19 pandemic brought profound changes to consumption and work habits. These changes have had large effects on commercial real estate (CRE), which is typically defined as the office, retail, industrial, and multifamily real estate sectors. For example, the ability to work from home (WFH) has spurred remote work and decreased demand for offices. While there was a significant return-to-office trend in early 2023, this movement seems to have stalled, with office occupancy at around 50% of pre-pandemic levels. As a result, many businesses are either not renewing their leases on office space or downsizing to smaller spaces. In retail, the growth of e-commerce has harmed brick and mortar businesses, especially regional malls. The multifamily real estate market has also been suffering from rising operating costs, slower rent growth, and rising costs of refinancing due to, among other things, rising interest rates.

Many institutions, including the Board of Governors of the Federal Reserve System, are concerned about the downside risks that the CRE market is currently facing. In their May 2023 Financial Stability Report, the Board of Governors noted weak long-run fundamentals due to WFH, elevated valuations and leverage, and rising interest rates as potential problems for the CRE market. Figure 1 compares an index of CRE debt and an index of CRE prices, both adjusted for inflation. It shows that while CRE prices have been recently declining, the total amount of debt backed by CRE has been roughly constant, which suggests that leverage is rising in this sector. This fall in collateral values can trigger solvency issues and lead to a wave of defaults, which in turn can cause problems for those who own this debt.

Who Is Exposed to CRE Risks?

With CRE risks looming, a natural question is, Who is exposed if default in the CRE market occurs? In Figure 2, we show a breakdown of the major owners of CRE debt. Banks and thrifts are the largest direct holders, accounting for nearly 40% of CRE debt. These represent direct CRE holdings at banks, such as a loan for a mall or an office building. However, an additional 34% is held in mortgage-backed securities (both agency and commercial), which in
We then compute a series of simple correlations with different bank characteristics. We find that banks with larger CRE exposures tend to be smaller (in terms of value of their assets), have lower liquidity ratios, lower tier 1 capital ratios, fewer loan-loss provisions, and lower market returns since 2019:Q4. Size is the characteristic most strongly correlated with CRE exposure: Figure 3 presents a scatter plot that shows this correlation. The $x$-axis measures the logarithm of assets, measured in millions of dollars, while the $y$-axis corresponds to the measure of CRE exposure as a percentage of assets. The figure displays a statistically and economically significant negative correlation between the two variables. Large banks, with assets over $100 billion (red triangles), tend to have significantly lower CRE exposure than the average commercial bank in the US. This negative correlation suggests that the risks from a potential downturn in the CRE are concentrated in smaller banks and not in the large bank holding companies that are commonly perceived as “too big to fail.” Still, as the 2007-08 Financial Crisis has shown, large waves of failures among even small institutions can generate significant disruptions in financial markets and later spread to the real economy. Our future research will use bank-level micro-data to assess the aggregate effects of large drops in CRE valuations.

**Note**


Figure 3
Bank Exposure to CRE

**CRE exposure, %**

BHCs
Large BHCs ($100 billion)

**NOTE:** CRE, commercial real estate; BHC, bank holding company. **SOURCE:** FR Y-9C and authors’ calculations.

turn tend to be securities held by banks. Therefore, when accounting for both direct and indirect holdings, banking institutions hold between 40% and 75% of all CRE debt, making them by far the most exposed institutions to CRE debt.

**Which Banks Are the Most Exposed?**

Not all banks are equally exposed to risks in the CRE sector. Different banks have different business models and often focus on lending to different areas: consumers, firms, specific sectors, etc. To understand how these exposures vary as a share of banks’ total portfolios, we collect detailed data on the balance sheet components of US bank holding companies from quarterly regulatory reports (FR Y-9C). The detailed data allow us to compute a measure of each bank’s direct and indirect exposures to CRE, as we observe not just loans that are secured by commercial and multi-family properties, but also a bank’s holdings of financial securities backed by CRE (such as commercial mortgage-backed securities). Our main measure of bank-level exposure is the total value of CRE loans and securities as a percentage of total assets.