



# Economics Group

**John E. Silvia, Chief Economist**  
[john.silvia@wellsfargo.com](mailto:john.silvia@wellsfargo.com) • (704) 410-3275  
**Misa Batcheller, Economic Analyst**  
[misa.n.batcheller@wellsfargo.com](mailto:misa.n.batcheller@wellsfargo.com) • (704) 410-3060

## CRE Credit: Fed Concerns, Tighter Standards & Less Demand

*Fed officials have continued to sound caution over the elevated level of CRE pricing. However, the slower pace of foreign investment and tightening CRE lending standards should help reduce regulators' concerns.*

### Fed Echoes Risks in CRE

As commercial property prices continue to rise higher, financial regulators have voiced concerns about potential imbalances forming in the commercial real estate (CRE) sector. Such worries were echoed last week in the Federal Reserve's Monetary Policy Report to Congress, which highlighted CRE prices as an area of "growing concern." While the statement noted that CRE debt remains modest relative to the size of the overall economy, it also reported the run-up in prices "may leave some smaller banks vulnerable to sizable CRE price decline."<sup>1</sup>

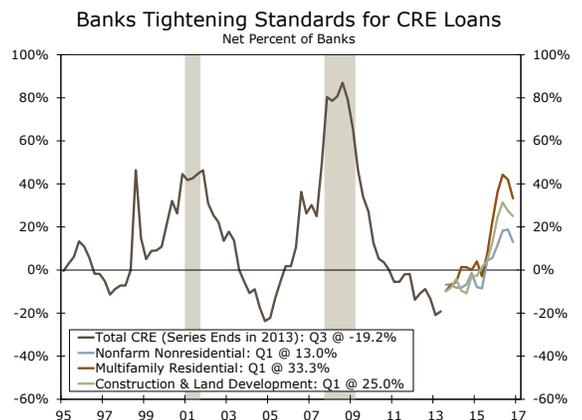
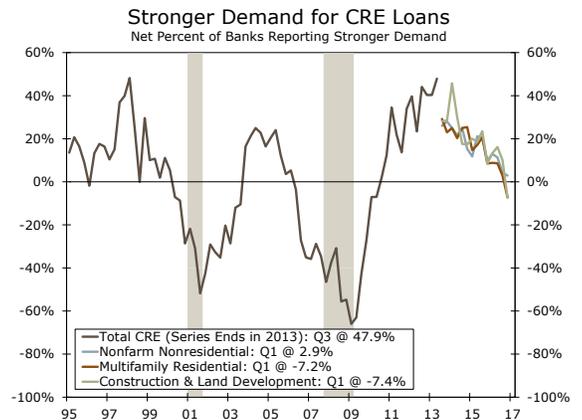
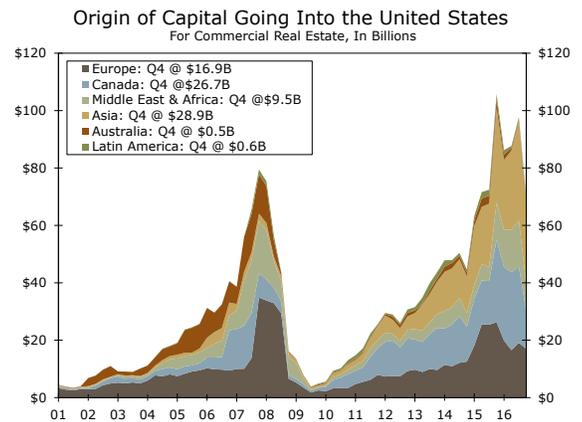
### Prices Higher but Asset Price Growth Is Moderating

Indeed, CRE prices continued to trend higher in 2016, with overall commercial property prices increasing 7.4 percent over the course of the year and a staggering 90 percent since 2010, according to data from Moody's/RCA. The sharp increase in valuations is largely due to the surge in cross-border transaction volume witnessed over the past five years (top chart). Regional markets and sectors preferred by international investors have seen the largest price gains. For example, the apartment sector reported a double-digit 12 percent price increase in 2016. That said, the pace of asset price growth is moderating as cross-border transactions and, in kind, overall transaction volume have slowed over the past year.

### CRE Credit Availability and Demand Wane

The slowdown in transaction volumes coincides with survey measures reporting weaker demand for CRE loans. According to the Federal Reserve's January Senior Loan Officer Opinion Survey, CRE loan demand has fallen. Lenders reported weaker demand for multifamily and construction loans on net in the fourth quarter, while nonfarm nonresidential loan demand was relatively unchanged (middle chart).

On the supply side, lending standards for CRE loans continued to tighten across the board in the fourth quarter, marking the sixth-consecutive quarter of net tightening (bottom chart). The Fed survey noted particularly "significant" tightening for loans secured by multifamily properties and construction land development loans, with a net 33.3 percent and 25.0 percent of firms, respectively, tightening standards. Meanwhile, a more moderate 13 percent of banks reported tightening standards for nonfarm nonresidential property loans. The survey data suggest that bank lenders are proving themselves more cautious/selective, consistent with indications that the sector is at a mature stage in the current cycle. The slower pace of foreign investment in U.S. CRE, and tighter lending standards for CRE loans, should provide some relief to Fed officials that have sounded caution over credit risks associated with the elevated level of CRE pricing.



Source: Real Capital Analytics, Federal Reserve Board and Wells Fargo Securities

<sup>1</sup> [https://www.federalreserve.gov/monetarypolicy/files/20170214\\_mprfullreport.pdf](https://www.federalreserve.gov/monetarypolicy/files/20170214_mprfullreport.pdf)

For further information on our CRE outlook, please see [Commercial Real Estate Chartbook: Q4](#), available on our website.

## Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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