

# More Banks Sound Alarm on Coming Trouble in Office Loans

Executives at Citizens, Morgan Stanley and US Bancorp Say Office Loan Restructurings Are Coming



Citizens Bank, which operates this branch in Providence, Rhode Island, set aside more money for potential losses on office loans. (CoStar)

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More banks are sounding the alarm that a surge in defaults on office loans is imminent.

Executives from Citizens Financial Group, Morgan Stanley and U.S. Bancorp told analysts during first-quarter earnings conference calls on Wednesday that they're gearing up to restructure loans in the coming months. The three banks also increased estimates for potential loan losses.

Troubles in the post-pandemic office market are spreading through the banking industry as property values decline amid persistently high vacancy rates. Blackstone last month [stopped making payments](#) on a \$325 million securitized loan for a Las Vegas office park after it was placed in special servicing.

“We think we will have some trouble in the book and we’re going to have to restructure a lot of the transactions,” Citizens head of commercial banking Don McCree said during a conference call, referring to office loans.

About a quarter of Citizens’ office loans are flagged for having an elevated risk of default, McCree said.

## Preparations

To prepare for the downturn, Citizens boosted its first-quarter loan-loss allowance to \$2.28 billion, a 2% rise from the fourth quarter. U.S. Bancorp increased its allowance by 2% to \$7.52 billion.

Morgan Stanley more than doubled its loan-loss provision to \$234 million, covering all types of loans. Commercial real estate represented 55% of that amount. Provisions use a different accounting method for measuring estimated losses. Morgan Stanley did not disclose the amount of its loan-loss allowance.

[Wells Fargo](#) and [M&T Bank](#) also increased loan-loss allowances in the first quarter on worries about office loans.

“Tenants’ behavior changes, sponsor behavior changes, those are going to cause some pressure in the industry,” U.S. Bancorp CEO Andy Cecere said during the call.

Banks are also hiring new employees to deal with the expected surge of problem loans, including staff who handle loan workouts, or restructurings.

“We have really staffed up our workout teams,” McCree said. “We are really putting each individual property, each individual [metropolitan area] under the microscope.”

## 'Manageable' Losses

Executives from the three banks stressed to equity analysts they believe problems within their office loan books won't lead to significant losses.

Citizens CEO Bruce Van Saun emphasized that the bank's \$29 billion commercial real estate loan portfolio is diversified among product types with 36% attached to multifamily properties and 22% backed by offices.

“We currently expect losses to be manageable and we have already set aside meaningful reserves,” Van Saun said.

Sharon Yeshaya, chief financial officer at Morgan Stanley, said during its conference call that the New York bank has been shrinking its commercial real estate loan book because of risk concerns.

“As you see economic deterioration, you do need to account for that,” Yeshaya said.

Bankers have said during this quarter's earnings reports that it remains an open question if the Federal Reserve will continue to hike interest rates. Citizens has hedges in place to manage risk for its floating-rate office loans, McCree said.

Regulators have [warned banks](#) for months to rigorously manage risks from office loans. Regulators have also paid extra attention to banks with high levels of commercial real estate loans compared to their capital levels.

Several regional banks report first-quarter earnings later this week, including Truist and Regions in the Southeast; KeyCorp, Fifth Third and Huntington in the Midwest; and Comerica in Texas.

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