

# U.S. Commercial Mortgage Defaults May Rise to 17-Year High

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By Hui-yong Yu

June 9 (Bloomberg) -- The default rate on commercial mortgages held by U.S. banks may rise to the highest in 17 years in the fourth quarter as debt for refinancing remains scarce and the recession drags down rents.

The rate is likely to reach 4.1 percent by year-end, Real Estate Econometrics LLC, a New York-based property research firm, said in a report today.

"The dramatic decline in real economic activity and labor markets since last September has undercut property fundamentals," wrote Sam Chandan, chief economist of Real Estate Econometrics. The decline puts an increasing number of loans "at risk," he said.

The projection implies defaults on about \$44.3 billion of commercial mortgages, based on the \$1.08 trillion of such loans held by U.S. banks in the first quarter, according to Chandan and Bloomberg calculations. Commercial defaults already are at a 15-year high after climbing to 2.3 percent in the first quarter, or \$3 billion, from 1.6 percent at the end of 2008, according to the firm's analysis of Federal Deposit Insurance Corp. data.

A default occurs when a loan is 90 or more days past due. A loan is considered delinquent when it's 30 to 89 days late.

The projection for this year would match the 4.1 percent rate seen in 1993 and be the highest since defaults reached 4.6 percent in 1992 during the savings and loan crisis, when the U.S. created the Resolution Trust Corp. to deal with bad loans, according to Real Estate Econometrics.

The first-quarter rate was the highest since 1994, when 2.7 percent of commercial mortgages defaulted, the company said.

## 2010-11 Projections

Default rates likely will increase next year and in 2011 as five-year loans made in 2005 and later start to come due, Real Estate Econometrics said. Those mortgages were based on overly optimistic forecasts of income growth and inflated property values.

The company projects the default rate on commercial mortgages will reach 5.2 percent by the end of 2010 and peak at 5.3 percent in 2011 before starting to decline.

"Mortgages originated in 2006 and 2007 are experiencing the most significant shortfalls in current cash flow relative to current debt-service obligations," the report said.

Commercial mortgages are defined in the report as loans on non-farm, non-residential buildings such as offices, retail centers and warehouses. They exclude apartment complexes.

The report makes a separate forecast for apartment buildings of five dwelling units or more. Multifamily defaults will rise to 4.5 percent by the end of this year from 2.5 percent in the first quarter, according to Real Estate Econometrics.

Multifamily defaults will peak at 5.5 percent in 2010, the firm estimated.

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