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By Dawn Kopecki

July 9 (Bloomberg) -- The $3.5 trillion commercial real estate market is a ticking "time bomb" that may lead to a second wave of losses at large U.S. banks, congressional Joint Economic Committee Chairwoman Carolyn Maloney said.

About $700 billion in commercial mortgages will need to be refinanced before the end of 2010 and "doing nothing is not an option," Maloney, a New York Democrat, said at a committee hearing today. This "looming crisis" may lead to significant losses for banks, force shopping center and hotel owners into bankruptcy, and impede economic recovery, she said.

The response by banks to this "growing threat has been slow and inadequate," said James Helsel, a partner at RSR Realtors in Harrisburg, Pennsylvania, and treasurer for the National Association of Realtors. "The lack of liquidity and banks' reluctance to extend lending are also becoming apparent in the increasing level of delinquent properties."

There were 5,315 commercial properties in default, foreclosure or bankruptcy at the end of June, more than twice the number at the end of last year, with hotels and retail among the most "problematic,' Real Capital Analytics Inc. said in a report yesterday. Losses on commercial mortgage-backed securities, or CMBS, will total 9 percent to 12 percent of the market, or as much as $90 billion, said Richard Parkus, a research analyst for Deutsche Bank Securities in New York.

Bottom Not Near

The bottom is several years away, and it will be at least 2012 before there is "palpable improvement" in the commercial real estate market, Parkus told lawmakers at the hearing. "It's hard to imagine fundamentals improving in an environment where we are beginning to see massive increases in defaults."

The largest concentration of distressed properties is in New York City, Helsel said. Las Vegas, Los Angeles, Detroit, Phoenix, Chicago, Dallas and Boston also have high distress rates, he said.

A tightening in issuance of CMBS, which used to account for about 30 percent of financing, has exacerbated problems, Jon D. Greenlee, the Federal Reserve's associate director for banking supervision and regulation, said in prepared testimony today. A disproportionately high number of small and medium-sized banks have "sizable exposure" to commercial real estate loans, and delinquency rates at around 7 percent in the first quarter are almost double from a year ago, he said.

"Market participants anticipate these rates will climb higher by the end of this year, driven not only by negative fundamentals but also borrowers' difficulty in rolling-over maturing debt," Greenlee said. "In addition, the decline in CMBS has generated significant stresses on the balance sheets of institutions that must mark these securities to market."

Fed Programs

The Federal Reserve has expanded its Term Asset-Backed Securities Loan Facility, or TALF, to new and existing commercial mortgage backed securities to jump start the market. Maloney said the Public Private Investment Program, or PPIP, may also help with the problem as officials release more details of its potential use.

Maloney said the TALF program expires at the end of this year, which may short cut its effectiveness "just as it begins to ramp up." She also said that uncertainty about the future of the PPIP has kept many investors "on the sidelines, so there's some urgency to the Treasury providing additional clarity about the program."

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