Statement of

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Chairman Kaufman and members of the Congressional Oversight Panel, my name is Dave Wilson and I am the Deputy Comptroller for Credit and Market Risk at the Office of the Comptroller of the Currency (OCC). I appreciate the opportunity to discuss the OCC's observations about the commercial real estate market and its impact on national banks. The OCC supervises 1,415 national banks, representing about 18 percent of all U. S. insured depository institutions, and approximately 63 percent of all IDI assets.

Commercial real estate lending is a prominent business line for many national banks and is a sector that the OCC monitors very closely. National banks hold approximately $735 billion in outstanding CRE loans, 16.5 percent of their aggregate loan portfolios.

While there are signs that the commercial real estate markets are beginning to stabilize, we are a long ways away from a full recovery. Vacancy rates across all major property types are starting to recover, but remain high by historical standards. We expect vacancy rates to remain elevated for at least the next twelve months.

Capitalization rates – the rate of return demanded by investors - have also shown recent signs of stabilization. Cap rates fell substantially from 2002 through 2007 to a point where they often did not fully reflect the risks associated with the properties being financed. Then they increased markedly in 2008 and 2009 as investors became more risk adverse. Recently, cap rates appear to have stabilized, particularly for high quality assets, but the spreads being demanded by investors, relative to Treasuries, remains wide.

A key driver for property values and CRE loan performance is the net operating income – or cash flows – generated by the underlying commercial properties. Overall, NOI has continued to decline due to soft rental rates. While we expect the rate of decline to lessen, only apartments are expected to show meaningful NOI growth this year, with other major market segments expected to turn positive in 2012.

Property prices have also shown some signs of stabilization. The Moody's All Property Index recorded an increase of 0.6 percent in November 2010, the third consecutive month of national price gains. While this trend is encouraging, we expect volatile prices until underlying market fundamentals improve consistently.

The trends and performance of CRE loans within the national banking system mirror those in the broader CRE market: While there are signs of stabilization in charge-off rates, non-performing loan levels remain elevated and continue to require significant attention by bank management and supervisors.

The effect of the distressed CRE market on individual national banks varies by the size, location, and type of CRE exposure. Because charge-off rates for construction loans led performance problems in the sector, banks with heavier concentrations in this segment tended to experience losses at an earlier stage. Performance in this segment is expected to improve more rapidly as the pool of potentially distressed construction loans has diminished. Conversely, banks whose lending is more focused on income-producing commercial mortgages are continuing to experience increased charge-off rates. Another factor for many community and mid-size banks is their significant CRE concentrations. Although CRE concentrations as a percentage of capital have trended downward for all national banks, they are still significant for many mid-size and community banks.

CRE concentrations and problem loan workouts continue to be areas of emphasis in the OCC's examination activities. Our objectives are threefold: ensuring that banks' accurately risk rate their loans, that banks work constructively with troubled borrowers, and that banks maintain adequate loan loss reserves and capital, taking appropriate charge-offs when needed.

We also are emphasizing the importance of stress testing and are assessing whether additional supervisory policies or guidance may be needed for examiners and bankers to more effectively deal with the risks that CRE concentrations can pose to the industry and the viability of individual financial institutions.

In summary, while there are modest signs of improvement, the CRE markets still face significant headwinds. Ultimately, stabilization of CRE markets will require restoring equilibrium between the underlying supply and demand and will hinge on recovery in the overall economy. This process is not painless, and we expect CRE portfolios will continue to be a drag on some banks' performance for at least the next twelve to eighteen months. During this period of adjustment, the OCC will continue to take a balanced and measured approach in its supervision.