Preferred Strategy

Who's most exposed to CRE?

CRE strain has caused concern among preferreds investors

Investor concerns over bank exposure to commercial real estate (CRE) loans have been renewed following last week's New York Community Bancorp (NYCB) earnings release, in which it reported a surprise loss and trimmed its common dividend—partially a function of its exposure to office and multi-family real estate (refer to our banks analysts' views on the name in their 02-Feb NYCB note and their 07-Feb NYCB note). Note that while NYCB cut its stock dividend, on 05-Feb it declared it would pay its next quarterly dividend on its outstanding Series A preferreds (NYCB 6.375% 2027). This has helped the NYCB preferred to largely outperform the stock since last week (Exhibit 6).

Regional bank issuers are most exposed to CRE loans

To determine which bank issuers (both of $25 par and $1000 par preferreds) are most exposed to CRE loans, we measured each's real estate loan balance and compared to its total loans, based on each's most recent filing. Notably, of all issuers that currently have CRE loans, 17 of the top 20 are classified as regional banks by GICS. The most-exposed names include Valley National Bancorp (VLY), Old National Bancorp (ONB), and Webster Financial Corp (WBS). While several large multinational banks have sizable CRE loan balances, they make up relatively small portions of their total loan portfolios (Exhibit 2).

The most CRE-exposed names have underperformed…

Unsurprisingly, we've found that preferreds from banks more exposed to CRE have underperformed those with less exposure, year-to-date. Specifically, the market value-weighted average return of the most exposed banks' preferreds (1st quartile) is just +1.0%, while the least exposed banks' preferreds (3rd and 4th quartiles) have returned +2.9% and +2.3% year-to-date, respectively. The link between CRE exposure and performance is even more pronounced among the preferred issuers' stocks, however, as 1st quartile names have dropped -7.2% year-to-date, on average, underperforming the less-exposed names, which have dropped no more than about -3.0% (Exhibit 3).

…but their impact on the market is, for now, fairly limited

Regardless of the relative weakness in heavily CRE-exposed banks, the preferreds market has held up quite well, in contrast to Q1 2023 when regional bank stress resulted in nearly their weakest performance on record (-5.6% in March 2023). Year-to-date, broad preferreds remain +3.0%, ahead of other fixed-income asset classes (Exhibit 1 and Exhibit 5). Indeed, though the space has numerous bank issuers with meaningful CRE exposure, their total weight is fairly limited—larger banks with more diversified loan portfolios comprise a much larger portion, by market value of outstanding preferreds (Exhibit 4). Specifically, the most CRE-exposed issuers (1st and 2nd quartiles) have just $22bn of preferreds outstanding versus the over $80bn of preferreds from the least-exposed (3rd and 4th quartiles). Still, though the market's reaction has been generally subdued thus far, 2023's experience suggests that preferreds are not immune should CRE stress persist—a worrisome risk according to some regulators (including Yellen).

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Preferred Strategy
United States

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Exhibit 1: Total returns year-to-date
Preferreds have outperformed all fixed-income asset classes year-to-date

Asset	Ticker	YTD return
S&P 500	SPXT	4.0%
Pfd	P0P4	3.0%
HY Corp	H0A0	-0.1%
IG Corp	C0A0	-0.5%
Govt	G0Q0	-0.9%
Cvt	VXA0	-1.0%

Source: ICE Data Indices, LLC. Data as of 06-Feb-2023.
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Abbreviations

- **CRE:** Commercial real estate
- **Cvt:** Convertible bond
- **GICS:** Global Industry Classification Standard
- **Govt:** Government bond
- **HY:** High yield
- **IG:** Investment grade
- **Pfd:** Preferred
- **YTD:** Year-to-date

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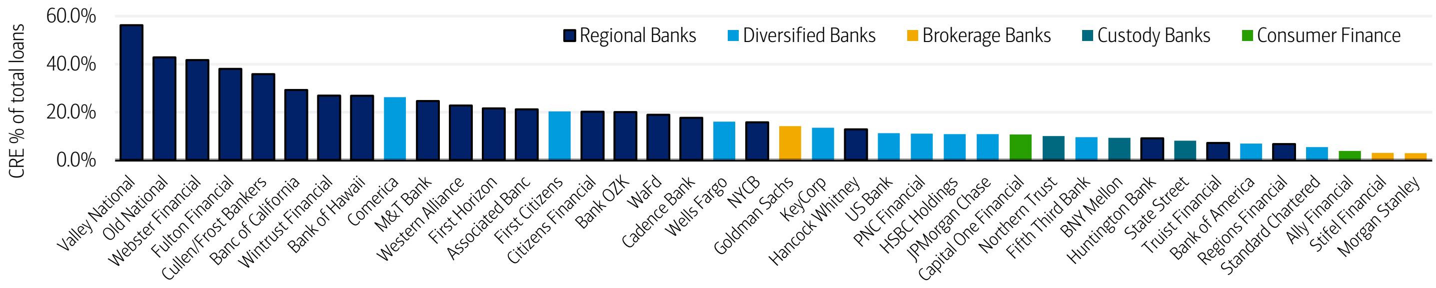
Exhibit 2: CRE-linked loans as a portion of total loans for preferred bank issuers (both $25 par and $1000 par)

Of all preferred bank issuers, the most exposed to commercial real estate loans are regional banks, such as Valley National, Old National, and Webster Financial



Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 06-Feb-2024 (fundamental loan data as of each issuer's most recent filing date).

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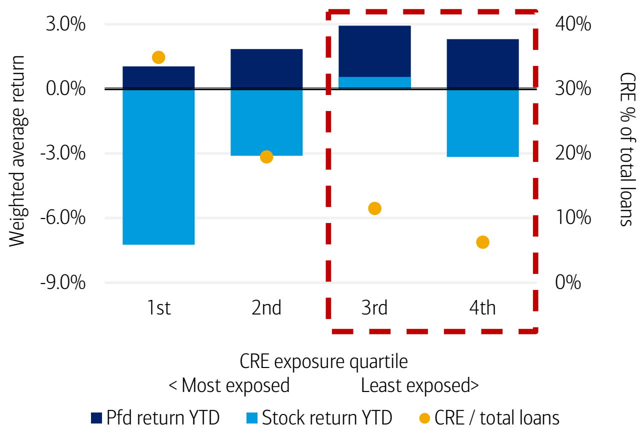
Exhibit 3: Preferred and equity YTD return by CRE exposure quartile

The most CRE-exposed issuers have underperformed YTD, though across buckets preferreds have held up better than their issuers' stocks



Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 06-Feb-2024.

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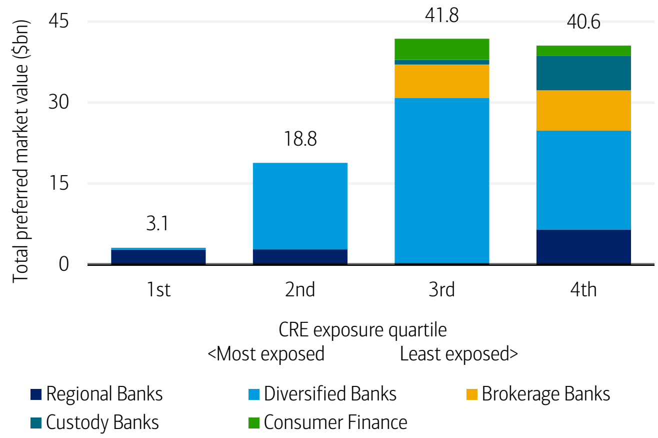
Exhibit 4: Total market value of CRE-exposed preferreds

While many regional banks are heavily exposed to CRE, the market value of their outstanding preferreds (and thus market weight) is relatively small



Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 06-Feb-2024.

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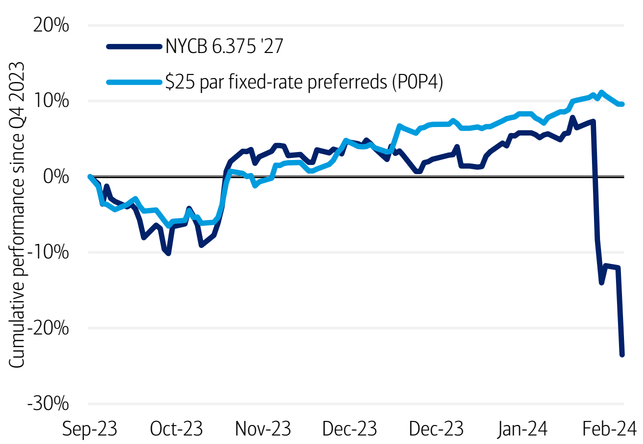
Exhibit 5: NYCB 6.375% '27 preferred v. $25 par preferred returns

Despite the ~30% plunge in price of NYCB's preferred since 31-Jan (and other regional bank declines), the broader preferreds market has held up



Source: BofA Global Research, ICE Data Indices, LLC. Data as of 06-Feb-2024.

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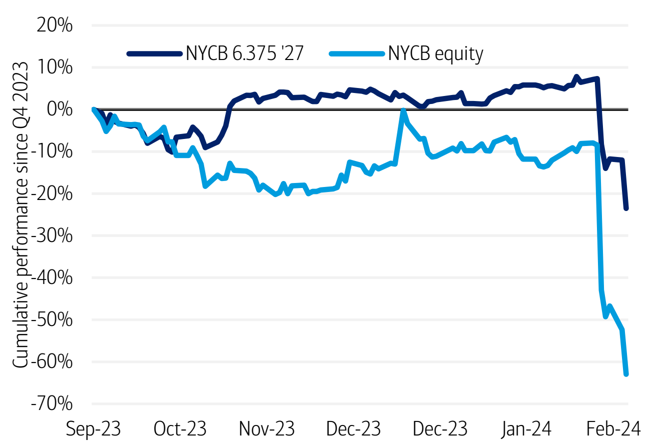
Exhibit 6: NYCB 6.375% '27 preferred v. NYCB common stock

NYCB's common stock has meaningfully underperformed its preferred since the company's earnings release on 31-Jan



Source: BofA Global Research, ICE Data Indices, LLC. Data as of 06-Feb-2024.

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