Regional Outlook

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A Message to Our Readers

The FDIC community extends its deepest sympathy to the families, friends, and co-workers of the victims of the attacks on September 11, 2001.

The articles in this edition of the *Regional Outlook* were prepared before the tragic events of September 11. We will assess the implications of these events in future issues of the *Regional Outlook.* The public can rest assured that deposit insurance is in full force—money is safe in an FDIC-insured account.

Regional Perspectives

◆ ***Differences in the Region's Local Economies Contributed to Bank Performance*****—The Region's counties did not benefit equally from the economic expansion of the 1990s. The Region's vibrant counties, those that exhibited the strongest economic performance during the latter half of the 1990s, tend to be the suburban and exurban rings around major cities. These counties experienced greater population growth, stronger job creation, and more industrial diversity than the less vibrant counties. Local economic conditions have contributed to differences in the performance and credit risk profiles among the Region's insured institutions. Banks in the Region's vibrant counties reported stronger loan growth and higher margins, but greater risk profiles, than banks in less vibrant counties.** *See page 3.*

◆ ***The Region's Office Markets Are Softening*****—Although the Region's office markets currently do not exhibit the overbuilding that was prevalent during the 1980s, significantly reduced demand for office space during the first half of 2001 has resulted in higher vacancy rates and softening rents. A slowing economy and weakening office market conditions in the Region's major cities may be affecting commercial real estate loan quality. During first quarter 2001, the ratio of past-due commercial real estate loans slightly increased; however, the ratio remained at a relatively low level historically.** *See page 7.*

By the New York Region Staff

In Focus This Quarter

◆ ***Slowing Economy Reduces Demand for U.S. Office Space*****—A slowing economy has contributed to softening in many U.S. office markets during the first half of 2001. The office vacancy rate has recorded the largest six-month increase in the past 20 years. A combination of trends—a substantial drop in demand for office space and an uptick in construction activity in some markets—has led to this slackening.**

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness. It notes the role played by the changing fortunes of high-tech firms in a number of U.S. metro areas and how this situation has contributed to large increases in the volume of space available for sublease. Finally, the article focuses on the local construction and commercial real estate loan exposures of FDIC-insured banks and thrifts that have the task of managing their risks under changing market conditions. *See page 11.*

By Thomas A. Murray

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Regional Perspectives

Region's Economic Buoyancy Has Been Uneven

Although it is said that a rising tide lifts all boats, some boats are more buoyant than others. The Region's economic tide certainly has risen since the beginning of the 1990s, although the degree to which its counties have benefited has varied. While certain areas of the Region have fared extremely well over the past five years, keeping pace with the nation's economy, others have not. Although the Region's insured institutions have benefited from healthy economic conditions during the latter half of the 1990s, differences in local economic conditions have affected banks' performance. With the nation's economic expansion losing momentum, this is an opportune time to review differences in the Region's economic performance and examine how these differences have affected conditions in the banking industry.

The Region's economy is diverse. To gauge differences in economic performance across the Region's 178 counties, this article ranks them by the degree of change since 1996 in five measures of economic performance. The performance measures include changes in employment, population, income, and single-family home prices. Industrial diversity relative to the nation also was derived. A significant variance from the nation suggests that an area is characterized by less industrial diversity, or a greater number of jobs concentrated in fewer industries. All else being equal, a difference also could indicate that a county might be more vulnerable to weakness in a concentrated industry. Counties that ranked in the top third, exhibiting the strongest economic performance, are referred to as "vibrant" counties. Counties that ranked in the bottom third are referred to as "less vibrant" counties (see Table 1, next page).[1] This article focuses on the counties that ranked in the top and bottom thirds in terms of change in economic performance over the past five years.

[1] Rankings of the five economic variables were summed to form a composite ranking for each of the Region's counties. Counties were then ranked by their composite rating and divided into thirds. Puerto Rico and the U.S. Virgin Islands were excluded from this analysis because of a lack of comparable economic data. Variance in industrial diversity from the nation was calculated using year-end 2000 employment figures. Personal income and population information by county was available through 1999. Employment growth and median single-family home prices were available through year-end 2000.

Big City Suburbs and Exurbs Lead the Region in Economic Performance[2]

The Region's vibrant counties tend to be the suburban and exurban rings around major cities, even as the central cities themselves experienced less than spectacular economic growth (see Map 1, next page). For example, a recent report from ***Rutgers University*** characterized the phenomenon in **New Jersey** as a geographic transformation, "a pattern of sustained suburbanization and economic deconcentration. Sprawling horizontal cities have emerged, centered around the state's suburban and exurban highway-oriented growth corridors."[3] While this phenomenon is most striking along the Region's I-95 corridor between **New York City** and **Washington, DC** (**Delaware, Maryland,** and New Jersey had the highest percentages of counties in the top third), it also applies to the area from New York City northward up the Hudson River valley to **Albany.**

The Region's vibrant counties gained population in the latter half of the 1990s, while the less vibrant counties lost population. A growing population base not only increases the available labor supply from which local businesses can draw but also can bolster demand for consumer products and services, stimulating economic growth. Between 1996 and 1999, the median population growth rate for the Region's vibrant counties was 2.8 percent, compared with negative 0.1 percent for the Region as a whole. Although Census 2000 data by county are not yet available, these trends suggest that many of the Region's vibrant counties have become home to an increasing number of residents from other parts of the Region and nation, as well as from other countries.[4]

Contributing to, if not causing, the population inflow into the Region's vibrant counties was a higher rate of job creation over the past five years. Labor force mobility is one of the hallmarks of a strong economy, and the Region's labor force has been migrating to where the

[2] Merriam-Webster's Collegiate Dictionary defines an exurb as "a region or settlement that lies outside a city and usually beyond its suburbs and that often is inhabited chiefly by well-to-do families."

[3] Hughes, James W., and Joseph J. Seneca. May 2001. *Sitar-Rutgers Regional Report.* Vol. 4, No. 2, p. 5.

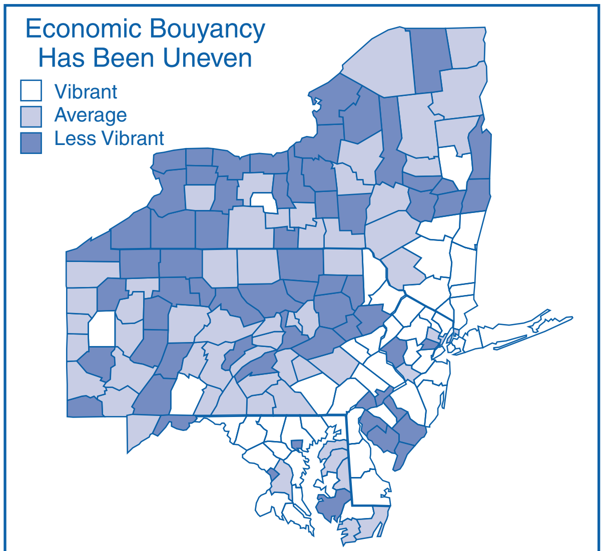
[4] Frey, William H. *Regional Shifts in America's Voting-Aged Population: What Do They Mean for National Politics?* 2000. Ann Arbor, Mich.: Population Studies Center at the Institute for Social Research, University of Michigan.

Table 1

Economic Performance Varies across the Region's Counties	Employment Growth (1996–2000)	Population Growth (1996–1999)	Personal Income Growth (1996–1999)	Median Single-Family Home Price Change (1996–2000)	Variance from U.S. Industrial Diversity* (4Q2000)
Vibrant Counties (Upper 3rd)	6.3%	2.8%	19.6%	31.7%	14.9%
Less Vibrant Counties (Lower 3rd)	–0.4%	–1.9%	11.3%	12.3%	28.4%
New York Region	2.2%	–0.1%	14.2%	20.2%	20.6%
United States	6.7%	2.8%	19.1%	31.7%	

Regional figures depict median absolute change over stated time period.
*Higher percentage means higher industry concentration than the nation. A county exactly as diverse as the nation would have zero variance.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Economy.com, Census Bureau, National Association of Realtors, WEFA, Haver Analytics

Map 1



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, WEFA, National Association of Realtors, Census Bureau, Economy.com, Haver Analytics.

jobs are being created. Between 1996 and 2000, median job growth in the Region's 59 economically vibrant counties exceeded 6 percent.

The degree of an area's industrial diversity also can affect its economic performance. As shown in Table 1, the Region's vibrant counties have a more diversified job base relative to the nation than the less vibrant counties. Additionally, some of the Region's vibrant counties have benefited from growth in the construction sector and the finance, insurance, and real estate (FIRE) sector, which has contributed to favorable trends in personal income levels and population growth. These industry sectors have been the engines of economic growth during the current business cycle. Moreover, salaries in these sectors, particularly in the securities industry, tend to be higher paying, providing a boost for counties with larger concentrations of these jobs.

Hand in hand with rapid job formation and population growth are personal income growth and demand for housing. As indicated in Table 1, personal income increased by almost 20 percent between 1996 and 1999 in the Region's vibrant counties. Higher income often translates into more money to purchase goods, services, and homes. Reflecting, in part, favorable trends in personal income and employment growth, the Region's vibrant counties experienced healthy gains in housing prices during the latter half of the 1990s, as median home prices increased by almost 32 percent between 1996 and 2000, similar to the national average.

Unfavorable Employment and Population Trends Hinder Region's Less Vibrant Counties

The Region's less vibrant counties demonstrate that not all areas have shared in the nation's economic expansion. Using our five economic categories as a barometer, these counties have shown signs of stagnant or modest economic growth at best and, in some cases, a decline in economic performance over the past five years. They have been adversely affected by negative or minimal employment growth and declining populations. Forty-five of the 59 less vibrant counties suffered net job losses between 1996 and 2000, and those that gained jobs averaged less than 0.5 percent growth. Furthermore, each of the Region's less vibrant counties experienced a net loss of population between 1996 and 1999.

The lack of industrial diversity also has played a role in the economic performance of the Region's less vibrant counties. Although these counties generally have reduced their reliance on manufacturing jobs over the past decade, their share of jobs in the manufacturing industry is roughly twice that in the Region's vibrant counties. The manufacturing sector has experienced long-term, structural job loss as manufacturers have relocated to lower-cost locations outside the Region. Furthermore, as the national economy slowed during the past 12 months, layoffs in the manufacturing sector have increased as demand for manufactured goods has declined. Additionally, the Region's less vibrant counties have fewer jobs in higher-paying construction and service industries and more in the government and military sectors.

Employment and population trends contributed to two other characteristics shared by the Region's less vibrant counties: low real personal income growth and minimal appreciation in home prices. At just over 11 percent, median personal income growth between 1996 and 1999 (the latest year for which data are available) in the less vibrant counties barely exceeded the nation's inflation rate. With a leveling off in real income, the median change in home prices in these counties also barely topped inflation over the same period. Changes in median home prices in these counties ranged from a decline of more than 5 percent to an increase of approximately 16 percent, compared with a 9.3 percent compounded rate of inflation between 1996 and 1999.

Differences among Region's Economies Influence Bank Performance

The rising economic tide has contributed to the generally favorable financial conditions reported by the Region's insured institutions. Reflecting robust economic conditions in the latter half of the 1990s, the Region's banks have benefited from strong loan growth, increased demand for banking services, and favorable credit quality. Furthermore, they generally have higher capital ratios than a decade ago. Nevertheless, local economic conditions have contributed to differences in performance and credit risk profiles among the Region's banks.

Banks in Vibrant Economies Report Stronger Loan Growth, Higher Margins, but Greater Credit Risk

Insured institutions Regionwide experienced strong loan growth during this economic expansion. Loan growth was slightly higher for institutions headquartered in the vibrant counties, averaging 11.3 percent annually between 1996 and 2000 compared with 9.4 percent annually for banks in less vibrant counties.[5] During this period, banks in the Region's vibrant counties moderately increased the proportion of commercial and industrial (C&I) and commercial real estate (CRE) loans to total loans, while reducing concentrations of residential and consumer loans. The portfolios of insured institutions in the less vibrant counties, however, remained largely concentrated in residential loans. By year-end 2000, the median ratio for commercial loans to total loans, including CRE and C&I loans, was 39 percent for banks in vibrant counties compared with 26 percent for banks in less vibrant areas. In contrast, the median ratio of residential loans to total loans was 47 percent for banks in vibrant counties, compared with 61 percent for banks in less vibrant counties.

The higher level of traditionally higher-yielding loans, such as CRE and C&I loans, has contributed to a favorable comparison of the average net interest margin (NIM) for banks in the Region's vibrant counties with those in less vibrant areas (see Chart 1, next page). During the latter half of the 1990s, NIMs declined for institutions throughout the Region, reflecting increased competition and a generally flat yield curve. Since 1999, however, margins earned by institutions in the vibrant counties have increased relative to those earned by banks in less vibrant counties. The larger proportion of commercial loans, which generally garner higher yields than residential loans, has contributed in part to the relative improvement.

Changes in bank funding structures also may have contributed to the difference in NIMs. Consistent with national trends, the ratio of core deposits to assets has declined across the Region as competition for core deposits has increased and loan growth has outpaced core deposit growth. A larger proportion of core deposits can enhance an institution's NIM because core deposits typically are a lower-cost source of funds than noncore funding. Insured institutions in the Region's less vibrant

[5] Banking analysis included 370 insured institutions headquartered in the vibrant counties and 166 institutions headquartered in less vibrant counties. Excluded from the analysis were institutions with assets greater than $40 billion, multinational institutions (those with more than 25 percent of assets in foreign offices), institutions in operation less than three years, and credit card banks. Institutions headquartered in the Region's three less vibrant counties that are surrounded by vibrant metropolitan areas also were excluded. All growth figures were adjusted for mergers.

counties, despite their greater focus on retail banking, have experienced declines in the ratio of core deposits to assets that parallel declines experienced by banks in the vibrant counties (see Chart 2). Less favorable population and personal income trends have challenged the ability of banks in less vibrant counties to grow core deposits. Between 1996 and 2000, core deposit growth averaged 3.5 percent annually for banks in the Region's less vibrant counties compared with 5.8 percent for banks in vibrant counties and 4.8 percent for the nation.

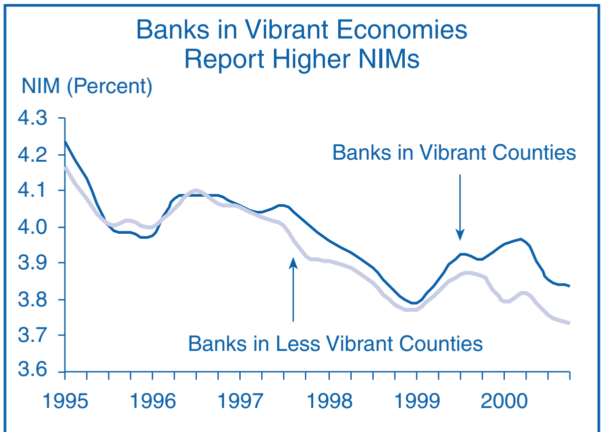
The maturity distribution of institutions' loan portfolios also may have contributed to differences in NIMs. Banks in the less vibrant counties reported a much higher median ratio of long-term assets to total assets (44.4 percent) at year-end 2000 than banks in vibrant counties (27.5 percent). Because residential loans tend to be lower yielding and longer term than commercial loans, the larger proportion of residential loans held by banks in the Region's less vibrant economies may have contributed to additional margin pressure during the late 1990s, a period of low long-term interest rates.

Although Overall Credit Quality Measures Are Favorable, Banks in Less Vibrant Counties Exhibit Greater Weakness

The greater concentration in residential real estate loans of insured institutions in less vibrant counties suggests a lower credit risk profile than is the case for banks with higher concentrations of commercial loans. Such a portfolio is less directly exposed to business lending risks, such as softening CRE markets or weakening in corporate earnings. Nevertheless, stagnant real personal income and modest employment growth over the past five years perhaps have contributed to more modest credit quality improvement for banks in the Region's less vibrant counties. During the latter half of the 1990s, the ratio of past-due loans to total loans declined across the Region; however, institutions in the Region's vibrant economies experienced greater improvement in the past-due ratio than those in the less vibrant economies. Moreover, recently the median past-due ratio for institutions in the Region's slower-growing economies, although still at a relatively low level, has increased more than has the ratio for banks in vibrant counties (see Chart 3).[6]

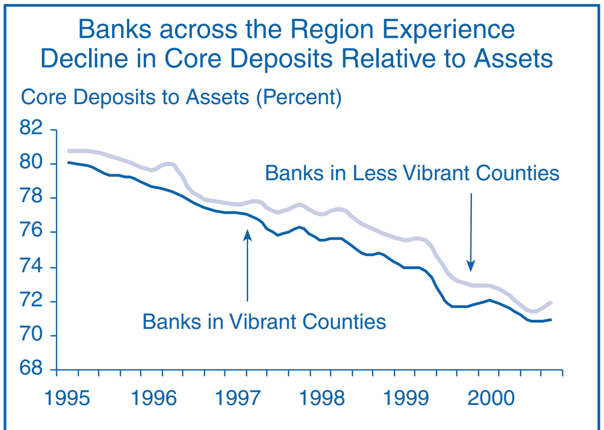
[6] At year-end 2000, the median past-due ratios for banks headquartered in the Region's less vibrant counties were higher across all loan categories.

CHART 1



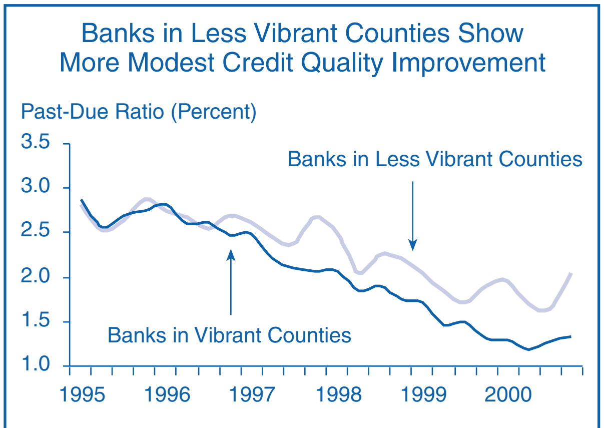
Note: Ratios represent median figures.
Source: Bank and Thrift Call Reports

CHART 2



Note: Ratios represent median figures.
Source: Bank and Thrift Call Reports

CHART 3



Note: Ratios represent median figures.
Source: Bank and Thrift Call Reports

Lessons Learned from the Eighties Banking Crisis

Despite these recent trends in credit quality, institutions in the Region's rapidly expanding economies, in fact, may be more vulnerable to losses than those in slower-growing economies. According to a ***Federal Deposit Insurance Corporation*** study of the banking crisis of the 1980s, bank failures that occurred a decade ago generally were concentrated in markets that had experienced rapid growth followed by a precipitous decline in economic conditions.[7] Insured institutions in the more robust economies responded to strong economic growth by providing financing for consumers, businesses, and real estate development. In some instances, however, rapid economic growth resulted in supply imbalances. During the 1980s, the New York Region, in particular, experienced significant speculative development in the CRE sector. As the economy softened and the economic "boom" devolved into a "bust," some CRE markets across the nation and the Region experienced significant deterioration in values that were ultimately absorbed, in part, by banks. (For more information on commercial real estate conditions in the Region, see Inset Box.)

[7] Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. I: An Examination of the Banking Crises of the 1980s and Early 1990s.* 1997. Washington, DC: FDIC.

Looking Ahead

The Region's insured institutions have experienced strong loan growth throughout most of this business

Region's Office Markets Softened in First Quarter 2001, but Conditions Differ from the 1980s

One key factor associated with rising levels of bank failures during the late 1980s was bank financing of speculative real estate development.[8] Unlike during the 1980s, however, office construction in the Region over the past five years was constrained, reflecting the overhang of space completed a decade earlier and a more conservative financing environment. As indicated in Table 2 (next page), the construction of new office space in the Region, as a percentage of existing stock, was significantly less between 1996 and 2000 than during the late 1980s. Moreover, demand for office space in the Region, as measured by absorption, significantly exceeded office completions during the latter half of the 1990s. This is in stark contrast to what occurred during the 1980s.

Economic Slowdown Spills Over into Region's Office Markets

Despite overall strong office market conditions, evidence suggests that some of the Region's major CRE markets may be experiencing the effects of the current economic slowdown. Accordingly ***Torto Wheaton***[9] states that 33 of 53 major metropolitan office markets experienced negative net absorption of office space during first half 2001 and 48 of those markets recorded rising vacancy rates from year end 2000 through June 2001. In other words, the amount of office space that became available during the first half exceeded the amount of space leased. According to Torto Wheaton, first quarter 2001 marked the first time this has occurred. The sudden drop in office demand reflected the return of space from numerous failed high-tech ventures and the reluctance of existing firms to contract for more space during a period of economic uncertainty and declining corporate profitability.

[8] Ibid.

[9] Torto Wheaton Research.

The Region's major office markets felt the effects of declining office demand as New York City, northern New Jersey, **Long Island, Philadelphia, Westchester, Wilmington,** and Washington, DC, experienced negative absorption. The Washington, DC, and Long Island metropolitan statistical areas (MSAs) experienced some of the most significant declines in office demand in the nation, reflecting, in part, a slowdown in the technology sector. As demand fell, office vacancy rates in all of the Region's major cities increased in first half 2001 (see Table 3, page 9). Higher vacancy rates were accompanied by an increasing number of reports that rental rates have softened around the Region.[10]

[10] See the following: Peter Grant, "More Office Space Is Staying Wide Open," *Wall Street Journal,* May 14, 2001; "Office Rents Drop in Manhattan," *New York Daily News,* May 9, 2001; John Jordan, "Westchester Office Market Slowing but Still Strong," Globe.com; "Vacancies on the Rise," *Pittsburgh Post-Gazette,* May 5, 2001.

TABLE 2

UNLIKE THE 1980S, IN THE 1990S OFFICE CONSTRUCTION WAS LIMITED AND DEMAND FOR OFFICE SPACE EXCEEDED NEW SUPPLY				
	COMPLETIONS TO SUPPLY* (%)		ABSORPTION/COMPLETIONS**	
METROPOLITAN AREA	1986–1990	1996–2000	1986–1990	1996–2000
BALTIMORE	51	14	0.69	1.33
LONG ISLAND	35	7	0.51	1.62
NEW YORK CITY	9	1	0.06	18.15
NORTHERN NEW JERSEY	43	6	0.76	2.60
PHILADELPHIA	38	8	0.78	1.35
WASHINGTON, DC	47	10	0.79	1.53
WESTCHESTER	29	3	0.28	5.22
WILMINGTON	88	7	0.42	2.57
UNITED STATES	26	10	0.72	1.45

* PERCENTAGE OF OFFICE COMPLETIONS OVER STATED PERIOD TO EXISTING SUPPLY AT THE BEGINNING OF THE PERIOD.
** REPRESENTS THE SUM OF OFFICE ABSORPTIONS DIVIDED BY TOTAL OFFICE COMPLETIONS DURING THE PERIOD.
VALUES LESS THAN 1.0 INDICATE CONDITIONS OF OVERSUPPLY, WHILE VALUES ABOVE 1.0 SUGGEST THAT DEMAND FOR OFFICE SPACE EXCEEDED SUPPLY DURING THE PERIOD.
SOURCE: TORTO WHEATON RESEARCH

Drop in Office Demand along with New Construction Could Take Some Steam Out of Office Markets

The outlook for the Region's office markets remains clouded by conflicting data regarding the direction of the national and regional economies. Unequivocally, the Region's office markets currently do not exhibit the excessive overbuilding that was prevalent during the 1980s. Moreover, despite the spike in office vacancy rates in the first quarter, vacancy rates in most of the Region's cities were relatively low at quarter-end. Softening demand for office space could result in further increases in office vacancy rates, while pressuring the relatively high office rents in some of the Region's office markets. However, the Region's office employment growth, an indicator of demand for office space, increased slightly in many of the Region's cities during first quarter 2001. Continued growth in office employment should help mitigate the dampening effect of subleased space returning to the Region's office markets. (For more information on commercial real estate trends, see *Softening Extends to Other Commercial Real Estate.*)

During first half 2001, some areas in the Region exhibited a large decline in office demand and a corresponding increase in vacancy rates while also registering an increase in the amount of new space under construction. Office construction has increased modestly in many parts of the Region, most notably in northern and central New Jersey, **Baltimore,** and the Washington, DC, MSA.[11] Construction in northern New Jersey reflected in part the overflow of demand from financial services companies from **Manhattan** and growth of telecommunications and technology companies such as AT&T, Motorola, Lucent Technologies, and Nortel. Growth of telecommunication, computer-related services, and bio-tech industries also has led to new office development in the areas surrounding Washington, DC, particularly suburban Maryland and northern **Virginia.** However, many of these industries have been severely affected by the recent softening in the economy. As a result, a large amount of previously leased space has returned to the market. While some construction projects may be under lease, information on the amount and strength of lease commitments is difficult to access. Furthermore, if corporate profitability continues to be strained, additional leased space could return to the market.

[11] The Washington, DC, MSA includes the District of Columbia and surrounding areas of Maryland, Virginia, and West Virginia.

Table 3

After Declining through the 1990s, Office Vacancy Rates May Be Nearing Bottom				
Metropolitan Area	1990	1995	2000	2001*
Baltimore	17.3%	13.9%	8.3%	8.9%
Long Island	22.2%	13.8%	9.0%	10.9%
New York City	15.5%	14.9%	2.8%	5.1%
Northern New Jersey	21.3%	17.8%	7.3%	10.9%
Philadelphia	16.7%	13.4%	9.9%	10.7%
Washington, DC	16.8%	9.5%	3.9%	7.8%
Westchester	21.9%	22.4%	11.3%	12.5%
Wilmington	22.6%	13.1%	6.2%	10.4%
United States	18.2%	13.8%	8.3%	10.8%

* 2001 amounts are for second quarter 2001.
Source: Torto Wheaton Research

Institutions in Region's Vibrant Areas Have Greater Exposure to CRE Lending

The Region's insured institutions that reported the highest proportion of CRE loans to assets[12] were clustered in and around the Region's major cities. Two-thirds of the banks with the highest levels of CRE loans are located in the New York, Baltimore, Washington, DC, or Philadelphia MSAs. Moreover, the Region's new institutions (those in operation less than three years) have been active in CRE lending. In fact, today's crop of new banks has a greater proportion of assets in CRE loans than their counterparts did during the height of the 1980s real estate boom. New banks' median concentration of assets in CRE loans was 14.9 percent as of year-end 2000, compared with 5.7 percent as of year-end 1988. While new banks represent 8.5 percent of the Region's institutions, they represent a disproportionate share (18.8 percent) of the banks in the top decile of CRE loans to assets. The majority of new banks that rank in the top decile of CRE loans to assets in the Region are located in the New York City or Philadelphia MSAs. (For more information on the Region's new banks, see the ***New York Regional Outlook***, first quarter 2001.)

[12] Analysis identified institutions that ranked above the Region's 90th percentile in terms of CRE loans to assets as of year-end 2000. The 90th percentile for the ratio of CRE loans to assets was 31 percent.

CRE Credit Quality Ratios Are at Favorable Levels; However, Trends Warrant Attention

Reflecting several years of strong economic growth and healthy office market conditions, the average delinquency ratio for CRE loans reported by the Region's insured institutions reached the lowest level during the current economic expansion at year-end 2000. Slower economic growth and weakening office market conditions in some of the Region's major cities, however, may be affecting CRE loan quality. Since mid-2000, the CRE past-due ratio reported by the Region's most active CRE lenders (those in the 90th percentile in terms of CRE loans to total assets) has increased slightly, although it remains below the national average. The average CRE loan past-due ratio for all banks in the Region moderately increased in first quarter 2001, consistent with the national trend; however, the ratio remains at a relatively low level by historical standards.

Although reported CRE credit quality remains strong, the potential effects of economic weakness on the Region's office markets warrant attention. Should office rents fall significantly, properties securing CRE loans may realize a decline in cash flow, which would affect debt service capacity. In addition, property appraisals or repayment schedules on CRE loans made at the height of the economic expansion that assume the continuation of very high rents may not be sustainable if the economic slowdown becomes more severe or prolonged. Therefore, financing terms for new office development should consider the potential effects of a further deterioration of office market conditions.

cycle, aided by favorable economic performance. Moreover, average capital levels for the Region's institutions are sound. The extreme economic imbalances the Region experienced in the 1980s do not appear to have been repeated during this business cycle. However, banks that operate in the Region's vibrant economies face different risks than those in less vibrant economies. Institutions in vibrant economies have a higher credit risk profile because of generally greater concentrations in commercial loans. Despite this higher credit risk profile, margins declined during the latter half of the 1990s, contrary to the traditional risk-reward trade-off. This decline in margins reflects, in part, a flatter yield curve and increased competition for funding and loans. Going forward, softening in the Region's vibrant economies may lead to weakened credit quality, further pressuring NIMs. Moreover, banks in vibrant markets face increasing competition from insured institutions and other financial service providers.

Although institutions in the Region's less vibrant counties generally have more conservative loan portfolios than those in vibrant counties, these banks, on average, reported less improvement in credit quality during the height of this economic expansion. Recently insured institutions in less vibrant counties also have reported greater weakening of credit quality. Moreover, the combination of lower-yielding loan portfolios and sluggish core deposit growth has contributed to greater relative margin compression for insured institutions in the Region's less vibrant markets. Steepening in the Treasury yield curve during the first half of 2001 has mitigated this situation somewhat. However, should margin pressure continue unabated over a prolonged period, some institutions may attempt to enhance profitability by shifting into traditionally higher-yielding, higher-risk assets such as commercial loans or expanding their geographic lending area, potentially heightening risk profiles.

By the New York Region Staff

Slowing Economy Reduces Demand for U.S. Office Space

- **Demand for U.S. office space contracted during the first half of this year as the amount of newly vacated space exceeded the amount of newly occupied space for the first time since at least 1981.**

- **The U.S. office vacancy rate jumped 250 basis points in the first half of 2001, from 8.3 percent to 10.8 percent.**

- **With construction levels remaining high and demand still weak, the vacancy rate could rise further by year-end.**

Overview

Commercial real estate (CRE) markets traditionally have been—and remain—highly cyclical. During the 1990s, most U.S. office markets experienced a strong upswing. However, declining office employment growth along with other recent signs point to a possible downturn. As reported by ***Torto Wheaton Research*** (TWR), the U.S. office vacancy rate, which stood at a 19-year low of 8.3 percent at the end of 2000, jumped in only six months to 10.8 percent, the largest six-month increase in the 20 years TWR has tracked these data. Office vacancy increases range from modest levels in some markets to high levels in markets where supply and demand imbalances are more pronounced.

An uptick in construction activity combined with a substantial drop in demand for office space has led to a slackening of office market conditions. In light of the ongoing uncertainty as to the near-term direction of the U.S. economy, these trends make the current situation difficult for office market participants to read.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness.[1] It notes the role played by the changing fortunes of high-tech firms in a number of metropolitan areas and how this situation has increased the volume of space available for sublease. Finally, the article focuses on the local construction loan exposures of insured banks and thrifts that have the task of managing their risks under changing market conditions.

Vacancy Rates Have Risen Quickly from Cyclical Lows

At year-end 2000, the U.S. office vacancy rate stood at 8.3 percent—a 19-year low. Many individual metro areas posted even lower vacancy rates. For example, at year-end 2000, vacancies were 4.4 percent of available space in Seattle, 1.3 percent in San Jose, and 3.0 percent in Oakland. Beginning with first quarter 2001, as a result of a slowing economy and the fallout from the so-called "tech-wreck," the U.S. vacancy rate rose by 120 basis points to 9.5 percent—the highest absolute quarterly increase since these data were first published in 1981. Another record increase of 130 basis points occurred during the second quarter, bringing the vacancy rate to 10.8 percent. To put these increases in perspective, consider that the national office vacancy rate has increased more than 50 basis points in any given quarter only twice.[2] Nonetheless, the current vacancy rate of 10.8 percent remains low by historical standards, as the average rate for the past 20 years has been 13.9 percent.

Most of the nation's large metro areas saw increases in office vacancies during the first half of 2001. Forty-eight of the 53 major metropolitan areas tracked by TWR recorded a higher vacancy rate in June 2001 than at year-end 2000. Thirty-eight markets experienced increases of at least 100 basis points, and four markets saw vacancy rates jump by more than 600 basis points. As shown in Table 1 (next page), most of the markets experiencing the largest jump in vacancy rates also are home to concentrations of high-tech employment.[3] As

[1] For further discussion of demand and supply trends, see Sally Gordon, "CMBS: Red – Yellow – Green™ Update, Second Quarter 2001 Quarterly Assessment of U.S. Property Markets," *Moody's Investors Service,* July 6, 2001.

[2] TWR notes increases of 60 basis points in the second quarter of 1989 and in the first quarter of 1999.

[3] Seven of the ten markets with the highest first-half 2001 vacancy rate increases are also among the top ten cities having the greatest levels of high-tech employment.

TABLE 1

In Many Markets, Office Vacancy Rates Reflect Concentrations of High-Tech Employment				
Metro Area	Vacancy Rate as of 6/30/01 (%)	Vacancy Rate as of 12/31/00 (%)	Increase in Vacancy Rate (basis points)	High-Tech as % of Total Market Employment
Austin	11.8	5.0	680	10.1
San Jose	8.1	1.3	680	27.4
Oakland	9.3	3.0	630	6.5
San Francisco	10.3	4.1	620	8.3
Seattle	9.4	4.4	500	6.6
Kansas City	15.9	11.0	490	2.7
Boston	8.7	3.9	480	8.2
Phoenix	16.9	12.5	440	4.7
Wilmington, DE	10.4	6.2	420	3.8
Washington, DC	7.8	3.9	390	7.8
Nation	10.8	8.3	250	4.8

Sources: Torto Wheaton Research, Economy.com, Inc.

high-tech markets spurred higher demand for office space in the recent past, these markets are now giving back greater quantities of previously occupied office space. Table 2 (see page 18) lists office vacancy rates and changes along with lending concentrations, construction activity levels, and high-tech employment percentages for 53 major metropolitan areas and for the nation.

Unlike the last cycle, during which office vacancies shot up primarily in overbuilt downtown areas, recent increases are occurring more sharply in suburban than downtown sections of metropolitan areas. As of June 30, 2001, the average downtown office vacancy rate was 8.5 percent, and the average for suburban markets was 12.1 percent. Increases in office availability are dispersed among Class A office properties as well as Class B/C properties, yet vacancy rates do show disparities across many submarkets. For example, the South of Market area in San Francisco reports significantly higher office vacancy rates than the Financial District.[4] Similarly, in the Washington, DC, metropolitan area, the technology-intensive northern Virginia office market has experienced higher office vacancy increases than downtown Washington, DC, or suburban Maryland.

[4] Louis, Arthur M. July 24, 2001. "Empty Offices, Economic Downturn, Overconstruction Leave Commercial Landlords with More Space on their Hands." *San Francisco Chronicle.*

Office Demand Drops

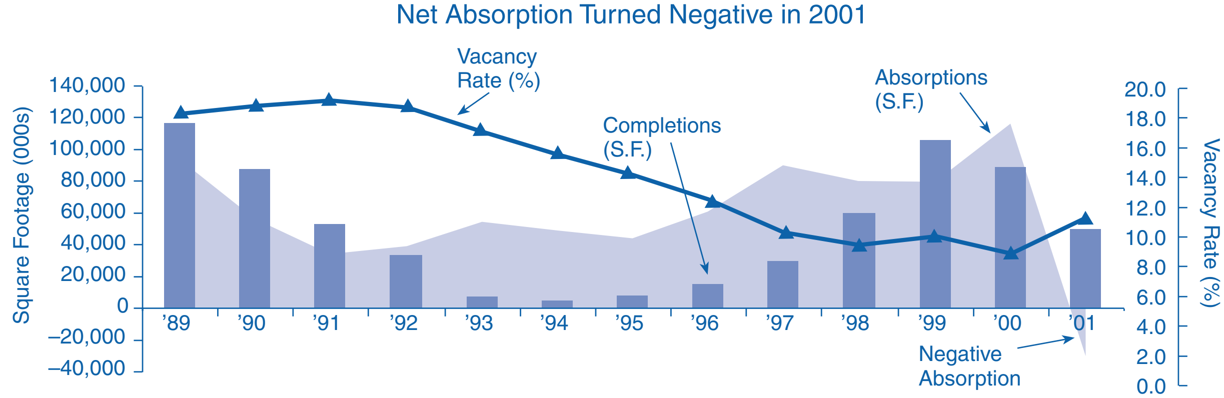
Net absorption, the primary indicator of demand for office space, was negative during first quarter 2001 for the first time since TWR began reporting the series.[5] (Negative absorption occurs when space returned to the market by existing tenants exceeds the space occupied by new tenants.) This negative performance was repeated in the second quarter. The decline in the volume of competitively leased space totaled 30 million square feet during the first half of 2001. (See Chart 1.)

The bulk of negative absorption in the first half of 2001 is due to the return of office space to the market through subleasing.[6] TWR reports that there were 43 million square feet of space "give-backs" through subleasing in the first half of 2001, and after offsetting absorption of 13 million square feet, negative absorption was 30 million square feet.

Office employment growth, the source of new office space demand, tends to be driven by the finance and services sectors.[7] Year-over-year job growth in the finance,

[5] Net absorption is the net change in total competitively leased space per period, as measured in square feet.
[6] In some metropolitan areas, over half the total office space available for rent (vacant space) is sublease space.
[7] TWR constructs its office employment index based on trends in the FIRE sector plus selected categories of the services sector. See *TWR Office Outlook,* Spring 2001, Vol. II, p. A.1.

CHART 1



Notes: 2001 is as of June 30. S.F. = square footage
Source: Torto Wheaton Research

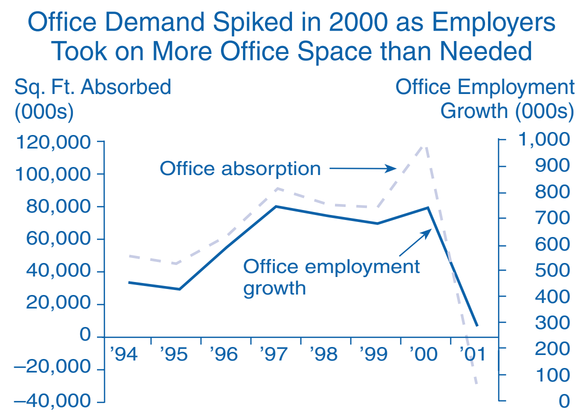
insurance, and real estate (FIRE) and services sectors combined was more than 3 percent in every month from January 1993 through June 2000. Since the middle of 2000, job growth in these sectors has fallen steadily to a year-over-year rate of less than 1.5 percent in June 2001. A spring 2001 survey conducted by ***Salomon Smith Barney*** indicated that tenants estimated their growth in office space demand to be only 0.6 percent over the following 12-month period.[8] Also contributing to reductions in demand are increases in worker layoffs. Announced layoffs during the first seven months of 2001 totaled over 983,000 individuals, more than triple the number of announced layoffs during the same period last year.[9]

The slowdown in the demand for office space contrasts sharply with the situation last year, when absorption rates and office employment growth were robust in most markets, and leases were executed quickly for newly constructed properties. As shown in Chart 2, absorption of office space in 2000 actually outstripped the trend in office employment by a considerable margin. Why? With relatively easy access to initial public offering and venture capital funding, many startup firms anticipated rapid growth and leased office properties accordingly. In fact, venture capital funding facilitated historically higher rates of office space absorption by high-tech and other startups. In active bidding wars, new high-tech firms increased their office space holdings. A phenomenon of *space hoarding* developed in which some high-tech companies leased large quantities of office space in anticipation of future expansion.

More recently, because of a slowing economy, curtailed funding, and failures to achieve sales expectations, many high-tech and dot-com firms have closed or scaled back operations significantly. At the same time, traditional firms have reconsidered plans to expand, adopting a "wait and see" attitude. Consequently, as demand for space declines, large blocks of office space are returning to markets for sublease.

Space available for sublease is similar to landlord-offered space available for rent—space under both categories should count toward a market's available rental space. However, in the case of subleasing, tenants, rather than landlords, offer properties for rent. Tenants may attempt to sublease the property themselves or use a broker; however, in general, only space handled by a broker is included in the tally of a market's available rental space. Consequently, current office vacancy increases could be higher than reported.

CHART 2



Note: 2001 is as of June 30.
Source: Torto Wheaton Research

[8] Boston, Gary, Ross Nussbaum, and Jonathan Litt. May 16, 2001. "Real Estate Demand Survey." *Equity Research: United States, Real Estate Investment Trusts.* Salomon Smith Barney.
[9] Data provided to Haver Analytics by Challenger, Gray & Christmas.

Meanwhile, Construction Continues

An uptick in office construction activity that began in many metro areas during the late 1990s has been a key element contributing to recent increases in office vacancies. According to the ***Bureau of the Census***, U.S. expenditures on office construction totaled $47.5 billion in 2000, continuing a seven-year cycle of expansion. Adjusted for inflation, this amount represents about 78 percent of the peak level of office construction expenditures that occurred in 1985. Recently, the pace of construction has slowed slightly, falling to an annualized rate of $44.3 billion in May 2001.

Reflecting these large dollar outlays on office construction, TWR projected in December 2000 that 111.3 million square feet of new office space (or 3.6 percent of existing stock) would be completed during 2001. This newly completed space will come on the market following a period of rising construction activity from 1998 through 2000, during which the volume of completed office space averaged 84.9 million square feet per year. As shown in Chart 3, however, current office construction activity as a percentage of existing stock falls well below that of the 1980s.

Many metropolitan areas currently experiencing high levels of construction activity also are seeing the largest increases in office vacancies. For example, cities that are positioned toward the upper right quadrant of Chart 4 are characterized by higher vacancy rate increases and more new office space construction. The ten cities with the highest first-half 2001 vacancy rate increases had total square footage of under-construction office space at 6.5 percent of existing stock as of year-end 2000.[10] By comparison, total office space under construction nationally was 4.5 percent of existing stock.[11]

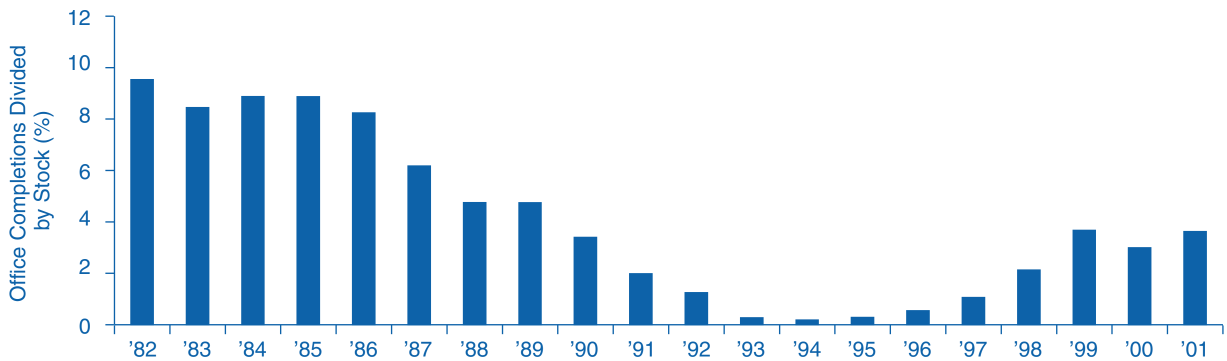
Even as most projects move toward completion, some developers are reconsidering office construction plans. Builders have stopped construction of significant projects midstream in the Austin, Dallas, Seattle, and northern Virginia markets in response to retrenchment by major tenants and competition from subleased space.

Softening Extends to Other Commercial Real Estate

Other major commercial real estate markets are also feeling the effects of a slowing economy and, with the exception of the retail sector, are experiencing increasing vacancy rates.

CHART 3

Office Construction Activity Increases in Recent Years yet Remains Well Below Level of the 1980s

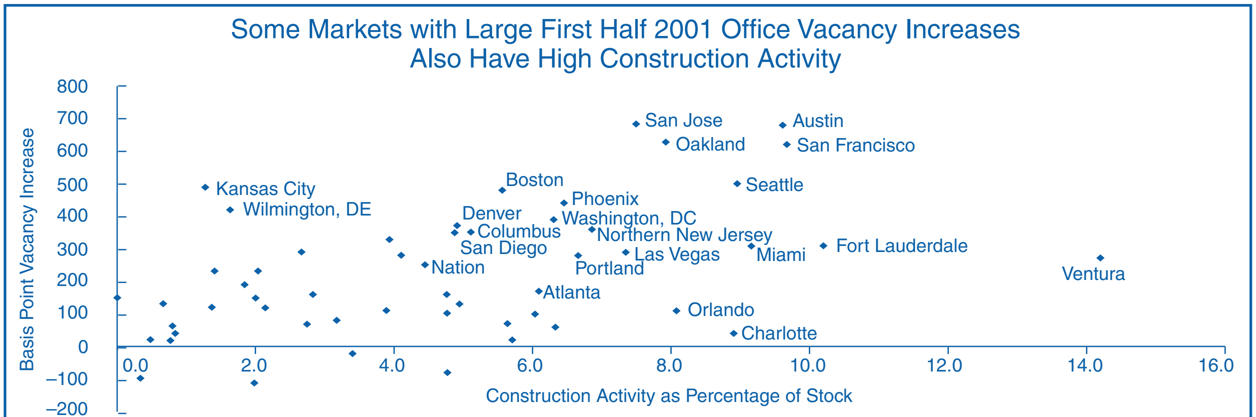


Notes: Construction activity is completions per year divided by prior year-end stock. 2001 is projected.
Source: Torto Wheaton Research

[10] One measure of a metropolitan area's exposure to overbuilding and rising vacancy rates is the degree of construction activity. This measure is found by dividing a metropolitan area's completions square footage or the under-construction square footage by the total stock of office property.

[11] The national 4.5 percent level for office properties *under construction* at December 2000 is higher than the 3.6 percent level for projected *completions* in 2001 because not all properties being built in 2001 will be completed during the year.

Chart 4



Note: Construction activity is measured by a market's under-construction square footage at year-end 2000 divided by total square footage in that market as of year-end 2000.
Source: Torto Wheaton Research, Spring 2001

Industrial vacancy rates had fared well in recent years. As of year-end 2000, the national vacancy rate of 6.7 percent was the lowest since 1984. Now, however, a 150-basis-point increase has occurred, with industrial vacancies increasing to 8.2 percent in the first half of 2001.[12]

As the economy and the nation's high-tech and manufacturing sectors continue to slow, demand for industrial space for research and development and storage and distribution is declining. Industrial property subleasing is on the rise, and negative absorption occurred in the first half of 2001. At the same time, completions of industrial space during 2001 are estimated to exceed 220 million square feet, the highest level since 1988. Landlords are offering concessions, such as lease terms of one year compared with five to ten years, in an attempt to attract new tenants.

Industrial properties are somewhat less exposed to risks from overbuilding than office properties because of shorter construction periods and the ability to respond quickly to any change in demand. An exception is the *telecommunication hotel,*[13] a new entry into this market. This property type is characterized by a longer construction cycle and the fact that it typically has a "single use" design. In recent months, construction of these structures began in many high-tech markets to provide enhanced levels of data service. With declining demand, some telecom hotels stand vacant.

The demand for **hotel** rooms is adversely affected by a slowing economy. Businesses have cut travel budgets and consumers have scaled back leisure plans, contributing to a decline in occupancy levels and revenue per available hotel room in most markets throughout 2001. Currently, upscale and luxury hotels are suffering more than limited service hotels. According to ***Smith Travel Research,*** limited service hotels, particularly budget hotels, represent the only lodging sector with higher occupancy levels through the first four months of 2001 when compared to the same four month period in 2000.

The supply of new hotel properties is lower than in the past, as financing for new hotel construction for the most part has been curtailed in recent years. However, limited service hotels are reported to be overbuilt in a number of markets in the Southeast and Southwest.[14] Annualized expenditures for new construction of all hotel types were $12.1 billion as of May 2001, falling to the lowest level since 1996.[15]

The **multifamily** sector has experienced robust construction and equally strong absorption in recent years as new household formation, the driver for apartment demand, continues to increase. Annualized construction expenditures of $25.5 billion as of May 2001 were at the highest level since 1989.[16] Despite the relative equilibrium between supply and demand for apartments in most markets, vacancy increases and rent declines are occurring in some locations. This decline has been most acute

[12] Torto Wheaton Research.
[13] Telecom hotels are large, high-energy-consuming warehouses that house machinery, servers, routers, and switches that are the physical underpinning of the electronic commerce conducted on the Internet. They are hotels in the sense that they house equipment belonging to many different telecommunication companies. John Holusha, "Home for Machinery of the Internet," *The New York Times,* August 16, 2000.

[14] Kozel, Peter P. June 18, 2001. "U.S. Commercial Property Markets in a Slowing Economy: Implications for CMBS Credit Performance." *Standard and Poor's Structured Finance.*
[15] Data provided to Haver Analytics by U.S. Bureau of the Census.
[16] Ibid.

in the more concentrated high-tech markets, such as San Francisco, where reported average rental rates dropped 8.1 percent between the end of March and the end of May 2001.[17]

Despite a slowing economy, the **retail** sector has performed reasonably well, as consumers maintain relatively high spending levels. Many of the store closings in 2000 and 2001 have been absorbed by new tenants as landlords have acted quickly to avoid letting vacant space linger. Meanwhile, robust construction has continued, with total expenditures in 2000 of $52.6 billion and an annualized level of $52.2 billion as of May 2001. Each of these two years' expenditure levels exceeds all previous years' retail construction amounts since data were first gathered in 1964.[18]

Taking note of the robust level of retail construction activity, a recent ***Moody's*** article finds that the nation's mall retail and "power center"[19] space grew by 3.3 percent in 2000, while population growth expanded by only 1.2 percent. The article raises concerns for potential excess supply of retail space resulting from a construction rate that is almost triple the population growth rate.[20] A negative consequence of the high rate of retail construction is found in a recent ***Standard and Poor's*** study. This article points out that most of the retail mortgages (held in commercial mortgage-backed pools of assets) that defaulted during 2000 did so because of competition from new retail establishments.[21]

Implications for Insured Institutions

Office vacancy rates during the first half of 2001 increased at an unprecedented rate. What does this mean for insured institutions? On the one hand, at mid-2001 vacancy rates remained below their 20-year average. Yet the speed of the increase and the number of metropolitan areas that have experienced softening make this a trend that deserves the close attention of insured institutions, especially those with significant concentrations in commercial real estate and construction lending.

Financial indicators of real estate credit quality in banking remain favorable, with losses and delinquencies trending up modestly from minimal levels. Noncurrent construction and development (C&D) loans as of March 31, 2001, remain at a relatively low .92 percent of all outstanding C&D loans. (Noncurrent C&D loans as a percentage of all C&D loans averaged .93 percent for the past five year-ends.) Similarly, noncurrent CRE loans[22] as of March 31, 2001, were .82 percent of all CRE loans, a level consistent with the average for this ratio of 1.08 percent for the past five year-ends. Charge-off ratios at March 31, 2001, for both C&D and CRE loans were each at .02 percent and remain below the averages of .05 percent for each for the past five year-ends. These favorable numbers are the legacy of a strong economic expansion, whereas current economic events suggest the potential for future deterioration in credit quality.

The outlook for commercial real estate credit quality depends on the depth and duration of the current economic slowdown and on the risk management practices of each institution. In this regard, as signs of increasing risk materialize in conjunction with a declining economy, lenders appear to be managing risks prudently and avoiding speculative lending.[23] Anecdotal information suggests that borrowers are pressed to obtain higher prelease commitment levels in order to gain loan approvals. In addition, lenders are requiring more up-front equity.[24,25]

The importance of risk management practices is magnified by the heightened lending concentrations currently prevailing at some banks. Institutions with elevated concentrations in CRE and C&D lending have been more likely to experience significant problems during times of economic stress (for further details,

[17] Associated Press, News in Brief from the San Francisco Bay Area, June 13, 2001.

[18] Data provided to Haver Analytics by U.S. Bureau of the Census.

[19] According to the Urban Land Institute, a power center is a community shopping center in which at least 75 to 90 percent of the selling space is devoted to multiple off-price anchors and a discount department store or warehouse club. It is the "power" of its anchors that gives the center its name.

[20] Sally Gordon, op. cit.

[21] Kozel, Peter P. April 20, 2001. "Outlook for Property Markets in a Slower-Growing Economy and the Implications for CMBS Credit Performance." *Standard & Poor's Structured Finance.*

[22] CRE loans are nonfarm, nonresidential loans secured by real estate.

[23] Speculative construction lending is defined as a loan not accompanied by a meaningful presale, prelease, or take-out commitment.

[24] "Capital Is Still Plentiful for Right Projects." *Midwest Real Estate News.* July 2001. Vol. 17, No. 7.

[25] Further information on bank underwriting practices can be found in Federal Deposit Insurance Corporation, Division of Research and Statistics, *Report on Underwriting Practices,* http://www.fdic.gov/bank/analytical/report/index.html.

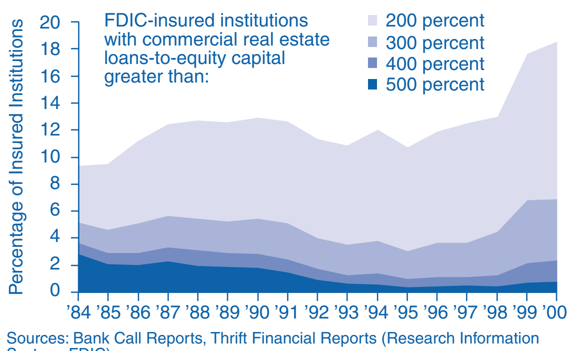
see *History of the Eighties*[26]). As shown in Chart 5, the percentage of insured institutions with commercial real estate loan concentrations between 200 and 400 percent of capital is higher now than it was in the late 1980s. However, there are relatively fewer institutions at the highest concentration level, in excess of 500 percent of capital. In fact, fewer than 1 percent of insured institutions are at this level. A similar story holds true for construction loans, as the increasing concentrations are in the range of 100 to 300 percent of capital (see Chart 6).

There are a number of issues for construction lenders and commercial real estate lenders to consider going forward. Because uncovered loans (C&D loans made without assurances of a firm take-out commitment) tend to be higher-risk, an important part of managing the risk in construction lending has traditionally been the lender's ability to obtain a take-out commitment.

Sources of take-outs for C&D loans include other insured institutions, pension funds, foreign investors, and life insurance companies, along with public-market real estate investment trusts (REITs) and conventional mortgage-backed securities (CMBSs). Anecdotal reports indicate that shifts in market sentiment in recent months have resulted in lowered investments in REITs and consequently less available capital for REITs to purchase real estate.[27] Insured institutions may face increased challenges to convert construction and development loans into permanent loans should the reported REIT situation become a trend and other sources of permanent capital become less available to purchase C&D loans.

Chart 5

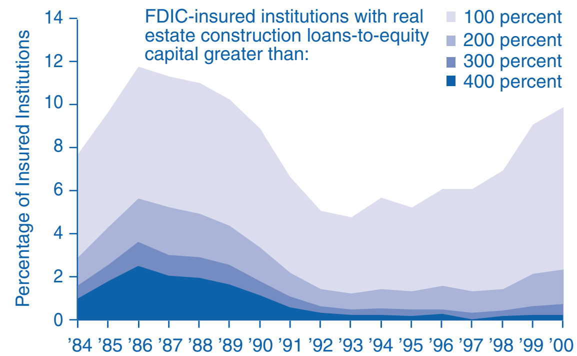
Concentrations of Commercial Real Estate Loans between 200 and 400 Percent of Capital Are Higher Now than in the Late 1980s



Sources: Bank Call Reports, Thrift Financial Reports (Research Information System, FDIC)

Chart 6

Concentrations of Construction Loans Have Moved Higher in Recent Years



Sources: Bank Call Reports, Thrift Financial Reports (Research Information System, FDIC)

Monitoring economic trends in general, and local real estate trends in particular, becomes even more important during a time of rapid change in market conditions. For example, reliance on appraisals based on outdated or top-of-market assumptions can result in a divergence between expected and realized collateral values or cash flows. Similarly, while preleasing commitments offer significant risk-reduction benefits to lenders, during a time of weakening economic conditions there is at least the possibility that a prospective tenant will be unable to honor a lease obligation, as has been the case with some firms in the high-tech sector in recent months.

Conclusion

Office market trends cannot, of course, be considered in isolation. The recent softening in office markets is a symptom of a slowing economy coupled with a rapid decline in the fortunes of some high-tech firms. Considered in this broader context, the challenge for insured institutions is simply to ensure that risk-management strategies are in place that will succeed under a more challenging economic environment.

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Senior Financial Analyst

[26] Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. 1: An Examination of the Banking Crises of the 1980s and Early 1990s,* Chapters 9 and 10. 1997. Washington, DC: FDIC. http://www.fdic.gov/bank/historical/history/index.html.
[27] Smith, Ray A. August 1, 2001. "Property Held by Public Firms Drops." *The Wall Street Journal.*

Table 2

Office Market and Banking Data on 53 Metropolitan Areas						
Metropolitan Statistical Area	2nd Quarter 2001 Office Vacancy	Basis Point Increase from Year End 2000	Count of Community Banks with C&D Loans	Median C&D as Percentage of Tier 1 Capital at 3/31/2001 (%)	High-Tech as Percentage of Total Market Employment (%)	Office Space Under Const/ Stock at 12/31/2000 (%)
Albuquerque	11.6	-110	9	61.0	6.8	2.0
Atlanta	9.8	170	76	172.2	3.8	6.1
Austin	11.8	680	20	53.4	10.1	9.6
Baltimore	8.9	60	60	22.8	3.6	6.3
Boston	8.7	480	100	24.1	8.2	5.6
Charlotte	9.0	40	20	48.5	1.7	8.9
Chicago	8.9	130	225	33.5	4.5	4.9
Cincinnati	10.1	100	58	32.6	3.1	6.0
Cleveland	13.6	40	16	34.8	3.0	0.8
Columbus, OH	16.9	350	20	22.4	3.1	5.1
Dallas	16.4	110	75	84.5	6.5	3.9
Denver	12.7	370	45	70.4	5.2	4.9
Detroit	12.0	160	28	35.2	3.1	2.8
Ft. Lauderdale	12.8	310	13	19.1	2.7	10.2
Ft. Worth	16.4	130	36	71.8	3.4	0.7
Fresno	14.4	20	5	196.0	0.9	0.8
Hartford	14.0	150	11	25.2	3.5	0.0
Honolulu	12.6	-190	3	11.4	0.9	0.0
Houston	13.6	60	48	65.8	3.1	0.8
Indianapolis	15.8	120	21	29.6	3.3	1.4
Jacksonville	11.7	-20	11	65.2	1.8	3.4
Kansas City	15.9	490	86	70.8	2.7	1.3
Las Vegas	14.5	290	19	117.7	1.5	7.3
Long Island	10.9	190	6	19.1	5.3	1.8
Los Angeles	14.1	150	62	35.4	3.7	2.0
Miami	10.5	310	26	28.1	1.8	9.2
Minneapolis	10.8	20	119	44.0	6.0	5.7
Nashville	12.8	230	20	78.4	1.2	2.0
New York	5.1	230	34	10.5	2.4	1.4
Northern New Jersey	10.9	360	66	15.0	5.6	6.9
Oakland	9.3	630	12	120.0	6.5	7.9
Oklahoma City	20.3	20	44	57.8	2.6	0.5
Orange County	14.7	330	14	34.5	6.4	3.9
Orlando	13.1	110	23	72.1	2.3	8.1
Philadelphia	10.7	80	68	22.1	4.5	3.2
Phoenix	16.9	440	27	114.2	4.7	6.5
Portland, OR	9.9	280	14	118.8	6.6	6.7
Riverside	14.4	-100	18	143.5	1.6	0.3
Sacramento	6.6	70	11	106.9	3.9	5.6
Salt Lake City	15.3	280	14	111.7	4.5	4.1

Table 2 (continued)

Office Market and Banking Data on 53 Metropolitan Areas						
Metropolitan Statistical Area	2nd Quarter 2001 Office Vacancy	Basis Point Increase from Year-End 2000	Count of Community Banks with C&D Loans	Median C&D as Percentage of Tier 1 Capital at 3/31/2001 (%)	High-Tech as Percentage of Total Market Employment (%)	Office Space Under Const/ Stock at 12/31/2000 (%)
San Diego	9.7	350	21	57.5	6.6	4.9
San Francisco	10.3	620	21	69.0	8.3	9.7
San Jose	8.1	680	5	174.5	27.4	7.5
Seattle	9.4	500	30	77.1	6.6	9.0
St. Louis	10.1	–80	80	40.4	2.6	4.8
Stamford	11.2	290	10	43.5	5.6	2.6
Tampa	14.8	70	33	40.0	4.2	2.7
Tucson	8.8	100	3	178.4	4.4	4.8
Ventura	14.2	270	8	49.7	5.4	14.2
Washington, DC	7.8	390	61	51.1	7.8	6.3
Wilmington, DE	10.4	420	12	28.4	3.8	1.6
W. Palm Beach	12.2	160	18	37.2	2.3	4.8
Westchester	12.5	120	4	19.5	12.3	2.1
Nation	10.8	250	(1) 3,801	(1) 40.1	(2) 4.8	(2) 4.5

Notes: Only community banks with construction loans are included in this table. Community banks are institutions with assets less than $1 billion. Noncommunity banks are excluded because their lending activities are likely to span a larger area than the MSA in which they are headquartered.
Sources: Torto Wheaton Research; Bank and Thrift Call Reports, FDIC Research Information System data; Economy.com, Inc.
1. Only community banks with construction loans and located within a MSA are included in these figures.
2. Percentages shown are the averages for the 53 metropolitan areas.

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