# Banks face rising risks from growing credit exposure to non-bank financial institutions and REITs



In the past decade, banks’ credit line exposure to non-bank financial institutions (NBFIs)—also known as ‘shadow banks’—has surged considerably, outpacing their exposure to non-financial corporations. Data reveal that between 2013 and 2023, bank credit lines extended to NBFIs tripled, rising from $500 billion to $1.5 trillion. As of 2023, over 20% of all bank credit lines were committed to these non-bank entities. A recent study by Acharya et al., highlighted in CEPR, focuses on the implications of this growing nexus between banks and NBFIs by examining a key segment—Real Estate Investment Trusts (REITs)—which serve as a critical conduit for commercial real estate (CRE) investment and bank exposure.

REITs hold a formidable position in the commercial real estate market, with investments exceeding $4 trillion, representing roughly 20% of the $21 trillion CRE market. Given this scale, fluctuations or disturbances in the CRE sector can have significant ripple effects on credit availability for households and businesses via the banking system. With rising interest rates and economic slowdowns increasing pressure on CRE assets, regulatory concerns have intensified around CRE loan risks. REITs, as large holders of CRE assets, inherit these inherent economic and financial vulnerabilities.

Nearly half of all bank-originated credit lines to public NBFIs are issued to REITs, and these entities display notably higher utilisation rates of bank credit lines compared to other NBFIs and non-financial corporations. Their credit line usage also exhibits greater sensitivity to overall market performance, spiking sharply during periods of economic stress such as the COVID-19 pandemic. This trend identifies credit lines to REITs as a potential significant source of systemic risk for banks.

Despite substantial REIT exposure, there is a common perception that CRE sector disruptions primarily impact smaller banks. Analysis of on-balance-sheet CRE loans relative to banks’ equity across three bank categories—community banks (assets under $10 billion), regional banks ($10 billion to $100 billion), and large banks (over $100 billion)—confirms that smaller institutions hold substantially higher direct CRE loan exposures. Specifically, regional banks’ CRE loan exposure is about four times their equity, and community banks' exposure nearly five times, while large banks demonstrate much lower on-balance-sheet CRE loan exposure. Over the past decade, regional and community banks saw a rising trend in this exposure, whereas large banks did not.

However, when including off-balance-sheet exposures like credit lines to REITs, a different picture emerges. It is crucial to consider not just direct CRE loans but also indirect exposures through term loans and credit lines extended to REITs, which are particularly concentrated within large banks’ portfolios. In fact, indirect exposure (through both term loans and credit lines) makes up around one-third of large banks’ total CRE-related exposure. For regional banks, indirect exposure is significantly smaller, and negligible for community banks, highlighting that large banks possess considerable CRE-linked risks hidden within NBFI credit line commitments.

The reasons behind REITs’ higher credit line utilisation, especially during market stress, relate partly to regulatory payout requirements. REITs must distribute at least 90% of their income as dividends, restricting their ability to accumulate cash reserves. Consequently, they rely on bank credit lines for liquidity during downturns and stress periods. Illustrative cases include Blackstone REIT (BREIT) in 2022 and Starwood Capital’s SREIT in 2024, both of which nearly maxed out their credit line capacity to fulfil investor redemption demands. Broader analysis further confirms significant positive correlations between redemption requests and credit line drawdowns across publicly traded REITs. Typically, REITs use these credit lines to finance property acquisitions and pay dividends during normal operating environments. However, during crises such as the Global Financial Crisis and COVID-19 pandemic, REITs shift behaviour: they prioritise cash accumulation, with approximately 72 cents of every dollar drawn from credit lines being held as cash buffers while halting new investments.

The impact of REIT credit line utilisation on banks is multifaceted. Unlike term loans, which are reflected on banks’ balance sheets and require capital funding along with provision for potential credit losses, credit lines are largely off-balance-sheet until drawn down and are less capital-intensive until utilised. In episodes of widespread market stress with simultaneous credit line drawdowns, banks face abrupt capital and liquidity constraints, reducing their capacity to intermediate credit effectively. Supporting this, researchers find that banks more heavily exposed to undrawn credit lines extended to REITs experienced lower stock returns during crises, underlining the capital encumbrance linked to these contingent liabilities.

Further analysis of capital requirements during aggregate market stress scenarios reveals that credit lines to REITs significantly increase banks’ expected capital shortfalls. Modelling a severe market correction scenario (a 40% drop in the MSCI Global Index), the study estimates that for publicly traded US banks, incremental capital requirements rise by about 20%, increasing from $180 billion to $217 billion primarily due to REIT-related credit line drawdowns. In contrast, direct CRE loan exposures add only an additional $2 billion to capital needs. Of note, over 90% of this additional capital burden falls on large banks, underscoring the systemic importance of indirect CRE exposure through REIT credit lines in the banking sector.

While the study focuses primarily on publicly traded REITs, the findings raise broader considerations for the expanding interconnections between banks and NBFIs more generally. Bank credit line utilisation among NBFIs has climbed from 25% in 2013 to over 50% following the COVID-19 crisis. Private NBFIs, which generally have even higher utilisation rates than REITs, account for nearly 60% of drawdowns by private firms, compared with around 30% for public firms. Additional NBFIs such as business development companies (BDCs) and collateralised loan obligations (CLOs) have also seen growing shares of bank credit line exposure, increasing from 28% to 42% within the total credit provided to NBFIs over the past decade. Given these patterns, stresses in the funding conditions of private NBFIs could similarly backfire on banks via the credit line channel.

The CEPR is reporting that the investigation into these dynamics illustrates a critical channel through which risks might be transmitted from non-bank financial intermediaries to banks, highlighting the importance of ongoing monitoring and regulatory attention to the interplay between banks, REITs, and broader NBFI sectors.

Source: [Noah Wire Services](https://www.noahwire.com)

## Bibliography

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