Retail Exposure Well Contained at Large U.S. Banks

Exposure Contained: Fitch Ratings views large U.S. banks' exposure to the challenged retail sector to be fairly well contained. Retail default rates are on the rise, and Fitch forecasts further retailer defaults as department store sales continue to decline in the face of online sales. For the largest U.S. banks, Fitch estimates aggregate exposure to the broad retail sector to be approximately $230 billion, with about $145 billion in commercial loans and $85 billion in commercial real estate (CRE), inclusive of retail-oriented REITs. However, banks' public disclosures on retail exposure are inconsistent, which presents challenges for direct comparisons among banks.

Retail Real Estate Exposure: U.S. bank balance sheet exposure to retail CRE represents approximately 14% of large bank CRE loans and about 9% of CET1 capital. Fitch believes the most concerning CRE exposures are to second- and third-tier enclosed malls, particularly properties with large anchor tenants whose businesses are most vulnerable to cannibalization by e-commerce sales. Exposure to the retail sector in U.S. banks' securities portfolios is immaterial; only 2% of securities portfolios in aggregate are held in non-government guaranteed CMBS, which also includes non-retail-related CRE exposure.

Retail Commercial Loan Exposure: Retail commercial loan exposure represents approximately 7% of commercial loans and 14% of CET1 capital. Banks have increasingly utilized asset-based lending (ABL) facilities, even for financially stronger retailers, to insulate themselves from downside risk. As ABL facilities are typically well secured, banks have generally incurred minimal losses when retailers default. Moreover, banks have actively reduced exposures to more challenged retail segments or retailers. Banks with exposure to large retailers with publicly traded debt also have the ability to hedge their credit risk with CDS, further insulating themselves from deterioration.

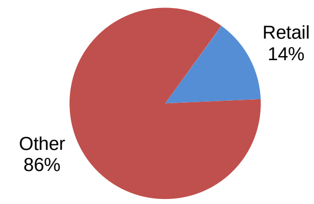
Not All Retail at Risk: While concerns around retail will persist, not all retailers are equally challenged. For example, exposure to convenience stores, grocery stores and gas stations is comparatively less risky than to retailers of consumer staples that aim to compete on price and are more susceptible to disruption by online retailers. However, this may change as online retailers look to expand their relationships with consumers, as evidenced by Amazon's recent acquisition of Whole Foods, which has led to declines in large grocery retailers' stock prices since the acquisition was announced.

Ratings View: Fitch does not foresee large banks' exposure to retailers becoming a rating issue given strong core earnings and healthy capital levels. However, the disruption in the retail sector highlights the need for banks to stay abreast of technological change and adjust their exposures accordingly.

Christopher Wolfe
Managing Director
+1 212 908-0771
christopher.wolfe@fitchratings.com

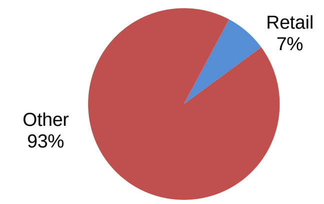
Michael Shepherd, CPA
Associate Director
+1 212 908-9138
michael.shepherd@fitchratings.com

CRE Loans for Large Fitch-rated U.S. Banks



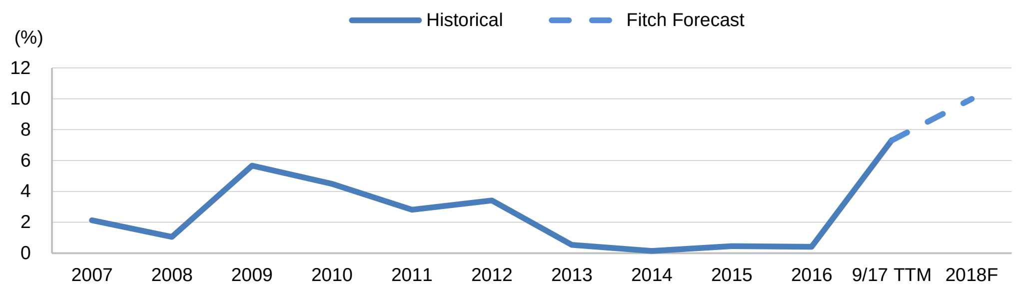
Note: CRE loans include loans to REITs.
Source: Company reports, earnings call transcripts and Fitch.

Commercial Loans for Large Fitch-rated U.S. Banks



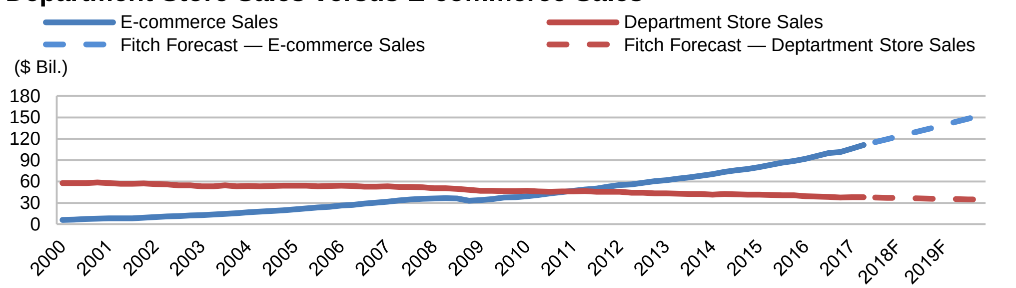
Source: Company reports, earnings call transcripts and Fitch.

Retail Institutional Loan Default Rate



F – Forecast (October 2017–December 2019).
Source: Fitch U.S. Leveraged Loan Index.

Department Store Sales versus E-commerce Sales



F – Forecast (October 2017–December 2019). Note: Department store sales exclude leased departments, measured in millions of dollars, quarterly, seasonally adjusted. E-commerce sales measured in millions of dollars, quarterly, seasonally adjusted. This chart is for illustrative purposes only as e-commerce sales include a broader range of products than department store sales.
Source: U.S. Bureau of the Census/FRED and Fitch Ratings.