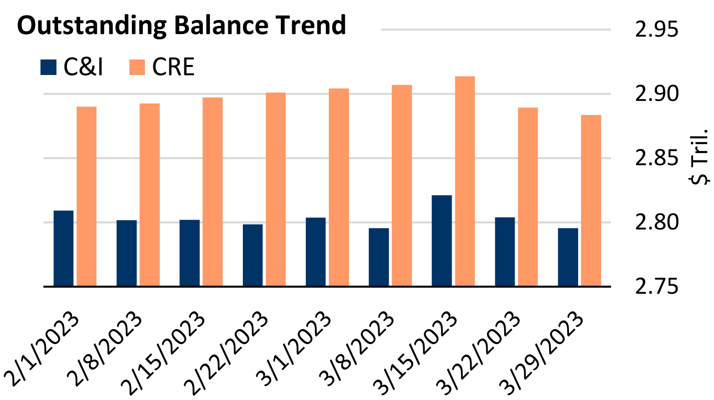
Commercial Loan Pricing Trends
April 2023

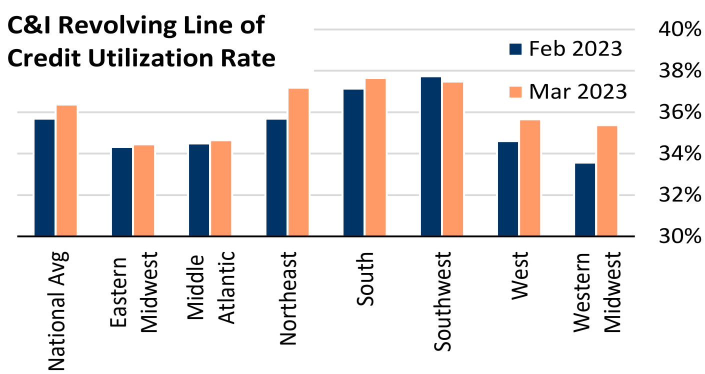
Earlier this year, we reported that banks had become more cautious about lending opportunities, choosing instead to optimize spread and fee levels on new borrowing. This sentiment intensified greatly in March following the failure of two prominent regional banks, as the rest of the industry contended with deposit runoff, rising cost of funds, and an economic outlook growing more uncertain. Despite these headwinds, commercial loan credit quality remained remarkably sound outside of a few stressed sectors such as Health Care (C&I) and Office (CRE). Banks also eased spreads for the best-rated borrowers, suggesting that they are still willing to capitalize on low-risk lending opportunities.

Noticeable pullback in C&I lending following prominent regional bank failures.

Well before the volatility in March, banks were already tightening underwriting standards and dealing simultaneously with a drop in business loan demand. During the week of the regional bank failures, C&I lending spiked as business borrowers tapped lines of credit to shore up extra liquidity. In subsequent weeks, both C&I and CRE loan volumes fell sharply as banks became even more cautious about lending opportunities. Much of the recent retreat in commercial loan balances has been focused in the smaller end of the market (deals under $5M in commitment size).



Source: Federal Reserve H.8 data release. Unadjusted balances.



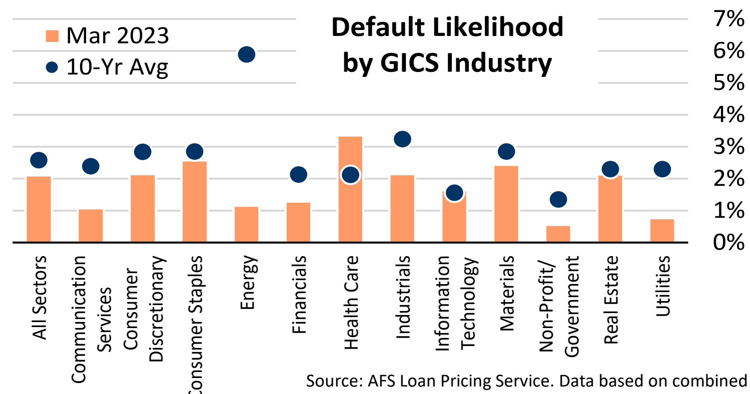
Source: AFS Loan Pricing Service. Data based on revolving lines of credit. Geographic detail based on the location of the borrower.

Line of credit utilization spikes as commercial borrowers react to bank failures.

The spike mid-March in C&I loan balances was driven by a sharp rise in line of credit utilization, in which commercial borrowers – including both smaller end and large corporate borrowers – drew down defensively on available lines. The overall increase in commercial line of credit utilization was reflected broadly across geographic regions, which illustrates how quickly news and the effects of the regional bank failures reverberated across the industry. On a month-over-month basis, the Northeast, West, and Western Midwest regions reported the sharpest increases in line of credit utilization, with only the Southwest region displaying a decline over this period.

Commercial loan credit quality remains sound outside of a few problem sectors.

Here, we plot the one-year weighted average probability of default (PD) for each GICS sector versus the 10-year average PD. For the majority of industries, default likelihoods are comparable to or better than historical averages. The Energy sector in particular shows a markedly improved default profile versus the historical average, while the current PD for the Financials sector – one of the largest C&I exposures – is also trending beneath the long-term average. One exception is the Health Care sector, in which issues with the Nursing Care subsector have caused problem loans to rise in recent months.



Source: AFS Loan Pricing Service. Data based on combined C&I and CRE activity. Data for accruing loans only.

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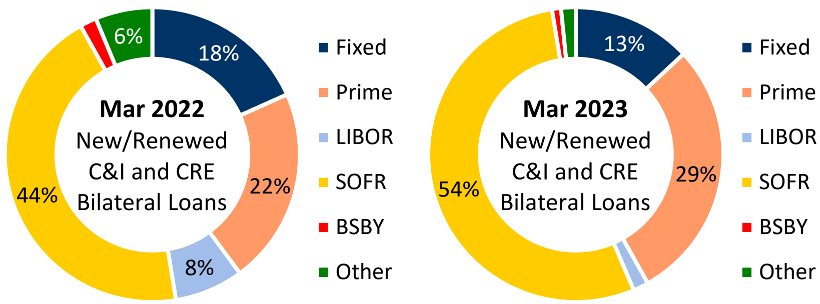


Source: AFS Loan Pricing Service

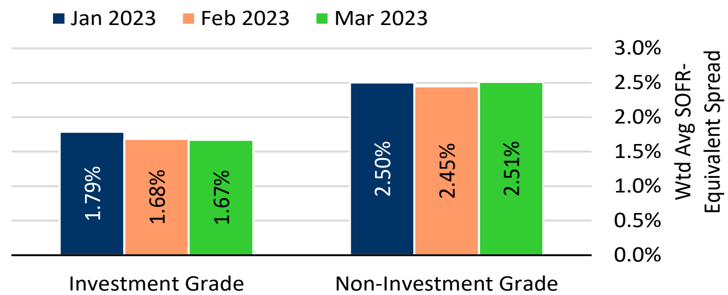
Fixed lending abates year over year in March.

In March, SOFR comprised more than half of the total dollar-denominated new and renewed deal flow, with Prime ranking second. Of note is that fixed lending as a percentage of total new/renewed volume declined five percentage points in March when compared to the same month a year earlier. While currently used infrequently, BSBY and Ameribor have gained acceptance in some niche sectors of the commercial loan market.

Spreads ease over the last couple of months for the best-rated credits.

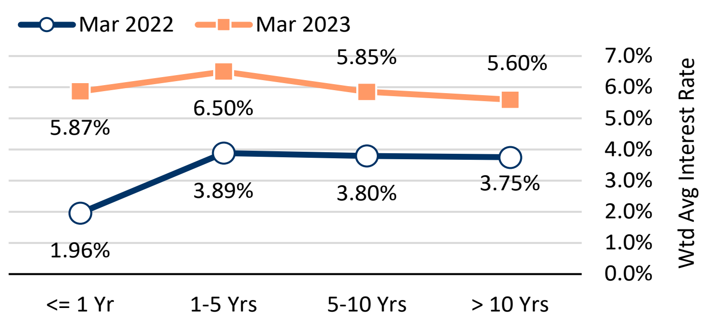
The chart on the right illustrates SOFR-equivalent spreads, in which the pricing for loans of varying types has been reindexed relative to SOFR. The SOFR-equivalent spread for investment grade C&I loans narrowed over the last couple of months, suggesting that banks are still willing to capitalize on low-risk lending opportunities. Conversely, the SOFR-equivalent spread ticked up 6 basis points from February to March for C&I loans risk rated non-investment grade.

New/Renewed C&I Bilateral Loans by Risk Grade



Source: AFS Loan Pricing Service. Investment grade loans represent deals with a bond-equivalent rating of BBB or better.

New/Renewed C&I Fixed-Rate Bilateral Loans by Term Length



Source: AFS Loan Pricing Service.

The commercial loan yield curve flattens year over year.

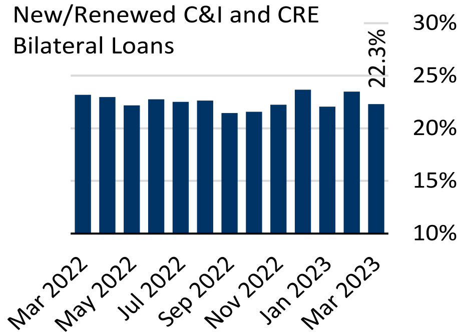
On a year-over-year basis, interest rates charged on fixed-based C&I loans rose higher in March for the shorter durations versus the longer-term lengths, thus resulting in an inverted pricing profile. This picture mirrors the trend and inversion in the treasury yield curve. With interest rate risk taking center stage in March, regulators have become more focused on fixed lending practices and bank funding mixes. Note that year over year, fixed-rated loans as percentage of new/renewed deal flow declined.

Upfront fee pricing remains low relative to prior months.

Fees remain an important and, in some cases, an unrealized revenue driver for banks. Upfront fee incidence – the percentage of loans assessed with an origination or renewal fee – was down slightly in March when compared to both February and the previous March. The weighted average upfront fee level rebounded slightly in March from February's large dip but remained low when compared to the levels realized in months prior.

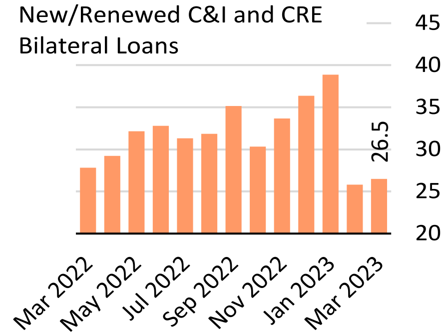
Upfront Fee Incidence

New/Renewed C&I and CRE Bilateral Loans



Upfront Fee Level Bps

New/Renewed C&I and CRE Bilateral Loans



Source: AFS Loan Pricing Service

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AFS Pricing Guidance File

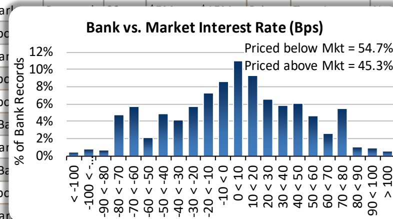
Market Intelligence Tailored to Your Bank ● Real Facts on Pricing ● Easy to Integrate Flat File Delivery

Segmentations (Lending Characteristics)
Filterable and sortable by indicative characteristics
Report is fully customizable: Additional parameters from the AFS Pricing Dashboard can be added to the report grid

Benchmarks (Metrics)
Balances, interest rates, spreads, and fees presented along with ***market-equivalent*** averages for each bank transaction

Vintage	Borrower Name	Obligation	Original Last Renewed Date	Maturity Date	Officer Name	Industry	Region	Line of Business	New/ Renewed	Risk Rating	Loan Size	Pricing Index	Product Type	Collateral	Bank Outstandings	Bank Interest Rate	Market Interest Rate	Opportunity
4Q	WeHeartShoes	61819	10/8/2021	3/11/2027	Corinne Sampson	Health Care	Houston	Business Banking	Renewed	03	$5M to < $15M	SOFR	Term Loan	Non-Real Estate	14,250,114	1.77	1.76	0.00
4Q	Refresh Random	42001	10/7/2021	6/30/2027	Addisyn Zimmerman	Food Services	Austin	Business Banking	New	06	$1M to < $5M	LIBOR	Line of Credit	Unsecured	2,228,754	2.37	2.23	0.14
4Q	The Green Thumb Guys	46595	11/2/2021	9/30/2027	Kyla Floyd	Manufacturing	Seattle	Middle Market	Renewed	02	$5M to < $15M	Prime	Term Loan	Non-Real Estate	14,429,423	3.01	3.36	-0.36
4Q	221A Random Street	17836	10/26/2021	12/31/2026	Andy Buck	Manufacturing	Boston	Large Corporate	New	07	< $1M	Fixed	Line of Credit	Unsecured	745,550	3.68	3.65	0.03
4Q	Tell Me About It	58329	11/12/2021	9/30/2024	Justus Mathews	Food Services	Portland	Middle Mar						Real Estate	5,382,035	3.89	4.76	-0.86
4Q	Snared Services	56264				Finance & Management	Charlotte	Large Corp						Estate	3,836,282	3.29	3.73	-0.44
4Q	Table Your Needs	80729				Food Services	El Paso	Middle Mar						Real		28		0.06
4Q	Don't Break a Bill	78103				Health Care	San Diego	Large Corp						Real		83		0.01
4Q	Admire Artists	77431				Accommodation & Leisure	Phoenix	Large Corp						Real		08		-0.46
4Q	Mystery Meats Co.	63406				Retail & Wholesale Trade	Chicago	Business Ba						Real		24		-0.29
4Q	Hook, Line, and Sinker	81202				Real Estate & Construction	El Paso	Middle Mar						cure		92		-0.31
4Q	Sanguine Services	10826				Real Estate & Construction	Boston	Business Ba						Real		90		-0.19
4Q	Maxxx Energy	42775	12/5/2021	12/31/2024	Keyla Sherman	Retail & Wholesale Trade	Seattle	Large Corp						cured	2,006,464	2.14	2.04	0.10
4Q	EtchSketch	19959	12/10/2021	6/30/2026	Rachael Roach	Real Estate & Construction	Los Angeles	Middle Mar						Real Estate	753,104	2.33	2.55	-0.22
4Q	Pop-Culture Partners	43999	11/13/2021	3/11/2026	Annabelle Powell	Food Services	Boston	Business Banking	New	03	$1M to < $5M	SOFR	Line of Credit	Real Estate	1,344,514	2.00	2.07	-0.07
4Q	The Helping Hands	50484	10/19/2021	6/30/2025	Lilianna David	Finance & Management	Austin	Middle Market	New	06	$1M to < $5M	LIBOR	Term Loan	Non-Real Estate	2,846,826	2.49	3.06	-0.57
4Q	Spilling The Beans Inc.	13445	10/7/2021	9/30/2023	Carla Holloway	Food Services	Phoenix	Business Banking	Renewed	05	$1M to < $5M	SOFR	Term Loan	Real Estate	2,678,997	2.00	2.24	-0.24
4Q	Scoot Over Services	44332	12/28/2021	3/11/2025	Precious Mcmillan	Retail & Wholesale Trade	Austin	Business Banking	Renewed	04	$1M to < $5M	Fixed	Line of Credit	Non-Real Estate	1,529,551	2.77	3.02	-0.25
4Q	Apples and Oranges	97975	11/3/2021	9/30/2024	Dashawn Valdez	Food Services	San Francisco	Middle Market	New	08	$5M to < $15M	Fixed	Line of Credit	Real Estate	5,306,270	3.41	3.24	0.18
4Q	Random Repairs	57971	12/19/2021	9/30/2023	Kaylah Arellano	Real Estate & Construction	Phoenix	Middle Market	Renewed	03	$25M to < $50M	LIBOR	Line of Credit	Real Estate	48,337,441	2.64	2.32	0.32

Segmentations (industry sectors, geographic regions, etc.) can be tailored to reflect the bank's unique reporting



Pinpoint and quantify pricing *outliers* for further analysis and remediation

Footnotes

1. The SOFR-equivalent spread for a new or renewed variable rate loan is calculated by subtracting the daily SOFR rate in effect as of the posted date of the loan from the actual interest rate. The SOFR-equivalent spread for an existing variable rate loan is calculated by subtracting the daily SOFR rate as of the last business day of the month from the actual interest rate.
2. The SOFR-equivalent spread for fixed-rate loans is calculated by subtracting the SOFR swap rate in effect on the day that the loan was originated or renewed from the actual interest rate.
3. The Spread for Prime- and SOFR-based loans is the difference between the all-in interest rate and the base rate.
4. A bilateral loan is a one bank, one borrower lending relationship. A participation is a borrower lending relationship involving more than one bank.
5. Geographic data refers to the location of the borrower, not necessarily the bank booking the loan.
6. Geographic Regions are based on states: Eastern Midwest (IL, IN, KY, MI, OH, WI), Middle Atlantic (DC, DE, MD, NC, NJ, PA, VA, WV), Northeast (CT, MA, ME, NH, NY, RI, VT), South (AL, AR, FL, GA, LA, MS, SC, TN), Southwest (AZ, CO, NM, OK, TX, UT), West (AK, CA, HI, ID, NV, OR, WA), and Western Midwest (IA, KS, MN, MO, MT, ND, NE, SD, WY).
7. CRE loans are investor real estate loans for the purpose of construction, land development, and other land loans; multifamily residential properties; and loans secured by other nonfarm nonresidential properties. Owner-occupied is not included.
8. Risk ratings based on a standardized 10-point obligor risk rating scale. This scale contains six "Pass" gradations, and the standard regulatory classification gradations of Special Mention, Substandard, Doubtful, and Loss (grades 7–10, respectively).
9. The Investment Grade risk rating category encompasses risk grades 1–4, while the Non-Investment Grade category encompasses risk grades 5–10.
10. Upfront Fee Incidence represents the number of obligations with upfront fees as a percentage of all obligations.
11. Upfront Fee Level (in bps) represents the amount of upfront fees assessed as a percentage of the original/last renewed amount for only those deals with upfront fees.

About this newsletter.

Drawn from our experience in the marketplace and one of the largest lending databases in the world, no other source has earned the title of trusted advisor to the extent that AFS has. Whether you seek performance metrics on your pricing tactics, credit quality or to take an in-depth, analytical look at your loan metrics, AFS provides best practices analysis and reporting capabilities that can transform your business. AFS Business Intelligence offerings have grown to include some of the industry's most crucial services. Top U.S. banks rely on our services to:

- Vet their approach to valuable credit and lending metrics
- Leverage revenue opportunities
- Validate benchmarking data with true-life experiences
- Mitigate risk
- Define ubiquitous metrics and terminology
- Provide in-depth, customizable and strategic reporting

If you have any questions about the insights that appeared in this article, please reach out to Don Dougherty, Director of AFS Business Intelligence, at ddougherty@afsvision.com or Doug Skinner, Director of AFS Business Intelligence, at dskinner@afsvision.com.