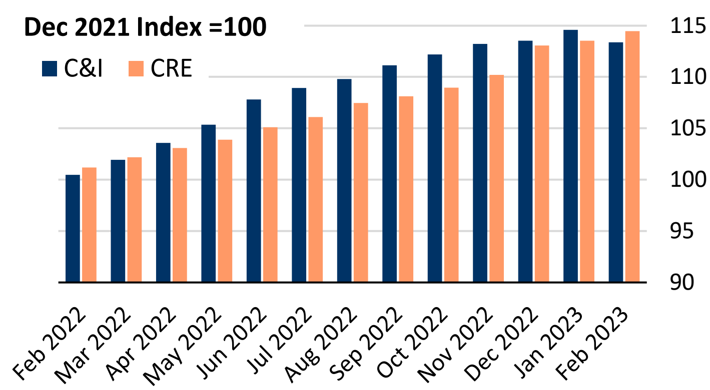
Commercial Loan Pricing Trends
March 2023

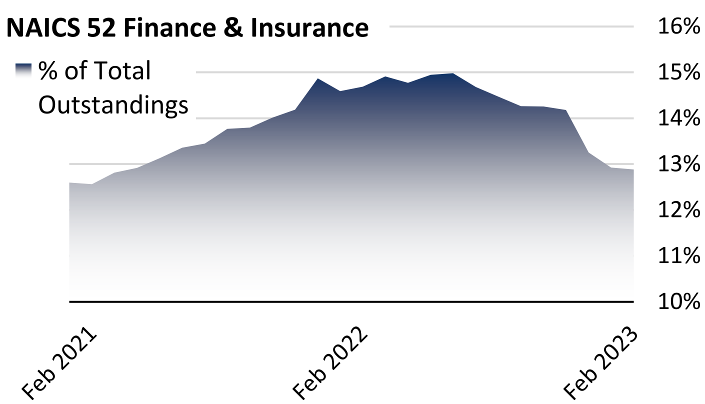
In recent days, the failure of two large banks has created financial turmoil not seen since the start of the pandemic. Despite inflation remaining stubbornly high, the Fed may choose to pause interest rate hikes at its next meeting in order to help restore confidence and stability in markets. With focus intensifying on bank exposure to venture capital and similar entities, in this edition we examine loan growth in the finance and insurance sector. Industry-wide C&I balances declined month over month in February, as higher interest rates charged on loans appear to have dampened business loan demand.

C&I loan growth slows due to higher credit costs and tighter bank lending standards.

Total C&I loan balances decreased from January to February, reflecting a combination of supply and demand factors. Banks have become more selective about lending opportunities, according to a recent Fed survey. Borrower demand has waned as well, as higher interest rates have made new borrowing more expensive. A couple of industries – Manufacturing and Utilities – bucked the national trend by posting solid C&I loan growth rates in February. CRE lending has been a steady contributor to bank balance sheets this past year, although the rate of increase is beginning to slow amid concerns about weaker fundamentals and rising delinquencies in the office property type segment.



Source: Federal Reserve H.8 data release. Seasonally adjusted balances.



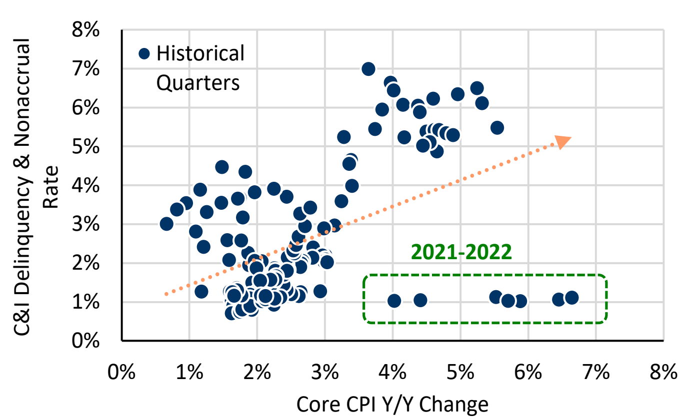
Source: AFS Loan Pricing Service. Contribution of NAICS 52 Finance & Insurance to total C&I and CRE outstanding balances.

Bank exposure to financial entities and intermediaries continues to fall.

For several years, the finance and insurance sector – representing private equity, portfolio managers, and nonbank intermediaries – consistently ranked among the fastest growing industries for C&I lending. Borrowers in these sectors are especially sensitive to rising interest rates due to their exposure to the leveraged loan market and other risky asset classes. In recent months, commercial banks have reduced their exposure to this sector, particularly as regulators more closely scrutinize these types of loans. In February, bank loans to the sector made up 12.9% of total commercial outstandings, down from a peak of 15.0% in June of the prior year.

Periods of high inflation have generally correlated with high levels of delinquent loans.

U.S. inflation eased slightly in February but remained high despite several large Fed rate hikes over the last several months. A concern is that high inflation will eventually strain debt service coverage and lead to a rise in delinquencies. When viewed over several decades, high inflation (x-axis) is positively correlated with the C&I delinquency and nonaccrual rate (y-axis). One exception is the 2021–2022 period in which problem loans remained manageable despite high inflation. Note that during the pandemic period, regulators allowed banks to not classify late payments as delinquent assuming borrowers were in good standing prior to the crisis.



Sources: U.S. Bureau of Labor Statistics and U.S. Federal Reserve

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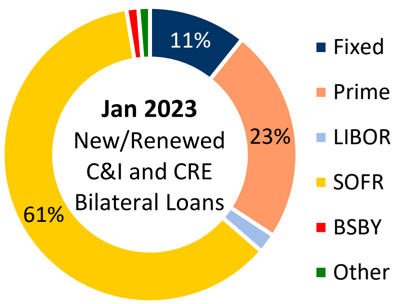
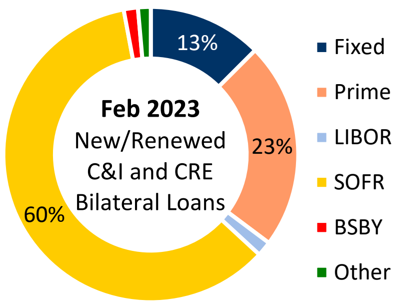




Source: AFS Loan Pricing Service

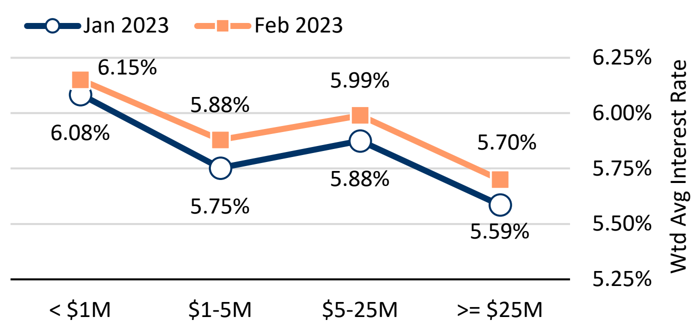
The percentage of volume with fixed pricing increased month over month.

In February, SOFR remained the predominant index for floating-rate loans. Over the last year, Term SOFR has surpassed daily SOFR as measured by deal volume for new originations and renewals. BSBY and other floating-rate alternatives have been used sparingly but are seen in niche sectors. Prime is the second most popular index in terms of new/renewed deal flow. Notably, fixed-rate bilateral volume increased meaningfully month over month in February.

Fixed loan yields rise across the commitment size spectrum.

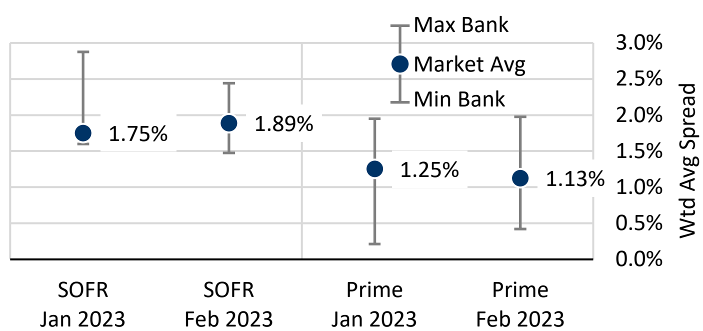
In light of recent market turmoil, the Fed may choose to pause interest rate hikes at its next meeting, although it is generally expected that more rate increases are needed this year to rein in inflation. Yields on fixed-rate C&I bilateral loans rose uniformly month over month across the commitment size spectrum, although in many cases increases in fixed-rate pricing have been beneath increases in treasury yields. In general, rates charged on fixed loans are inversely correlated with deal size.

New/Renewed C&I Fixed-Rate Bilateral Loans by Deal Size



Source: AFS Loan Pricing Service

Spread Pricing - New/Renewed C&I Bilateral Loans



Source: AFS Loan Pricing Service. Prime spreads based on commitments under $1M in size.

Spreads rise for SOFR loans but narrow slightly for Prime loans.

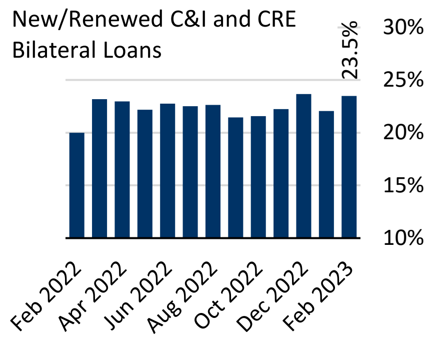
The weighted average spread for new/renewed bilateral loans tied to SOFR – representing the bulk of deal flow in February – increased 14 bps month over month, as banks in many cases have prioritized optimizing spread levels for new borrowing. For SOFR deals, we also observed more narrow pricing dispersion among the banks and fewer high outliers. In contrast to the trend for SOFR loans, the weighted average spread for Prime-based loans narrowed from January to February.

Upfront fee pricing falls significantly in February from last month's peak.

In recent months, many banks have become more selective about lending opportunities and have prioritized optimizing spread and fee levels. Upfront fee incidence – the percentage of loans assessed with an origination or renewal fee – rose in February to the second highest reading seen over the last year. Conversely, the weighted average upfront fee level fell sharply from January to February. The drop was driven heavily by the real estate sector.

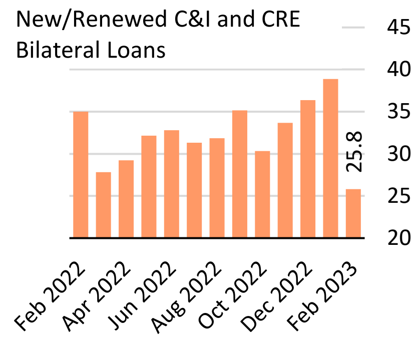
Upfront Fee Incidence

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

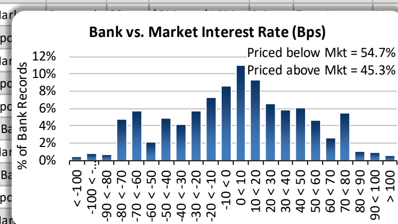
Market Intelligence Tailored to Your Bank ● Real Facts on Pricing ● Easy to Integrate Flat File Delivery

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	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real Estate	5,382,035	3.89	4.76	-0.86
4Q	Snared Services	56264	[illegible]	[illegible]	[illegible]	Finance & Management	Charlotte	Large Corpo	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Estate	[illegible]	3.29	3.73	-0.44
4Q	Table Your Needs	80729	[illegible]	[illegible]	[illegible]	Food Services	El Paso	Middle Mar	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real	[illegible]	[illegible]	[illegible]	0.06
4Q	Don't Break a Bill	78103	[illegible]	[illegible]	[illegible]	Health Care	San Diego	Large Corpo	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real	[illegible]	[illegible]	[illegible]	0.01
4Q	Admire Artists	77431	[illegible]	[illegible]	[illegible]	Accommodation & Leisure	Phoenix	Large Corpo	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real	[illegible]	[illegible]	[illegible]	-0.46
4Q	Mystery Meats Co.	63406	[illegible]	[illegible]	[illegible]	Retail & Wholesale Trade	Chicago	Business Ba	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real	[illegible]	[illegible]	[illegible]	-0.29
4Q	Hook, Line, and Sinker	81202	[illegible]	[illegible]	[illegible]	Real Estate & Construction	El Paso	Middle Mar	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	cure	[illegible]	[illegible]	[illegible]	-0.31
4Q	Sanguine Services	10826	[illegible]	[illegible]	[illegible]	Real Estate & Construction	Boston	Business Ba	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Real	[illegible]	[illegible]	[illegible]	-0.19
4Q	Maxxx Energy	42775	12/5/2021	12/31/2024	Keyla Sherman	Retail & Wholesale Trade	Seattle	Large Corpo	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	cured	[illegible]	[illegible]	2.04	0.10
4Q	EtchSketch	19959	12/10/2021	6/30/2026	Rachael Roach	Real Estate & Construction	Los Angeles	Middle Mar	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	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 LIBOR-equivalent spread for Prime- and LIBOR-based loans is calculated by subtracting the one-month LIBOR rate (as of the last business day of the month) from the actual interest rate.
2. The LIBOR-equivalent spread for fixed-rate loans is calculated by subtracting the Federal Reserve 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 LIBOR-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. Industry categories are based on the North America Industry Classification System (NAICS): Accommodation, Entertainment, & Food (71, 72), Finance & Management of Companies (52, 55), Health Care (62), Manufacturing (31, 32, 33), Mining and Transportation (21, 48, 49), Real Estate & Construction (23, 53), Retail & Wholesale Trade (42, 44, 45), and Other (11, 22, 51, 54, 56, 61, 81, 92).
8. 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.
9. Risk Ratings based on the RMA 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).
10. The Investment Grade risk rating category encompasses RMA Grades 1–4, the Non-Investment Grade category encompasses RMA Grades 5–6, and Criticized encompasses RMA Grades 7–10.
11. New/renewed trends exclude loans risk rated Substandard, Doubtful, and Loss (grades 8–10, respectively).
12. Upfront Fee Incidence represents the number of obligations with upfront fees as a percentage of all obligations.
13. 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 article.

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:

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- 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.