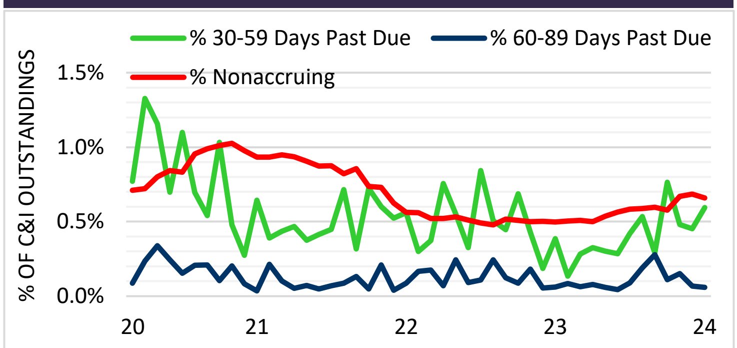
Commercial Credit Quality Bulletin

February 2024

C&I, Commercial Real Estate Loan Growth Picture Remains Murky, Banks Still Cautious on Credit

As the fourth quarter earnings calls wrapped up banks generally reported limited loan growth, stabilizing deposits, and weakening credit trends. Commercial and Industrial (C&I) lending contracted again in January, and demand remains subdued. This month the Federal Reserve released their quarterly Senior Loan Officer Survey on underwriting practices, and conditions remain generally unfavorable for lending to large and middle market firms. A net 25% of responding loan officers reported weaker demand for commercial credit from the prior quarter, and a net 15% of banks tightened standards since the prior quarter. While the prospects of a Fed pivot have improved considerably in recent months, borrowers, including prospective borrowers, are still faced with high lending rates, which will serve as a headwind throughout 2024.

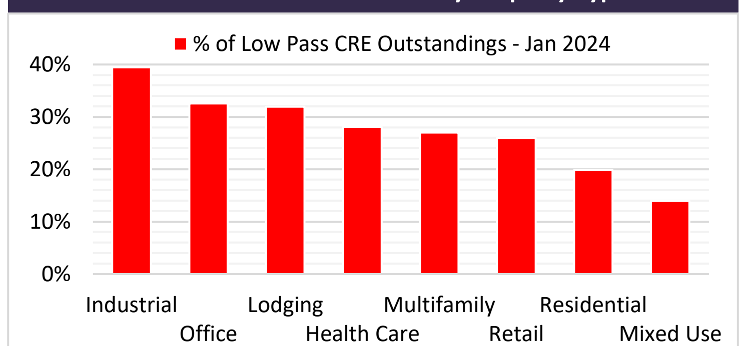
C&I Delinquency and Nonaccruing Trend



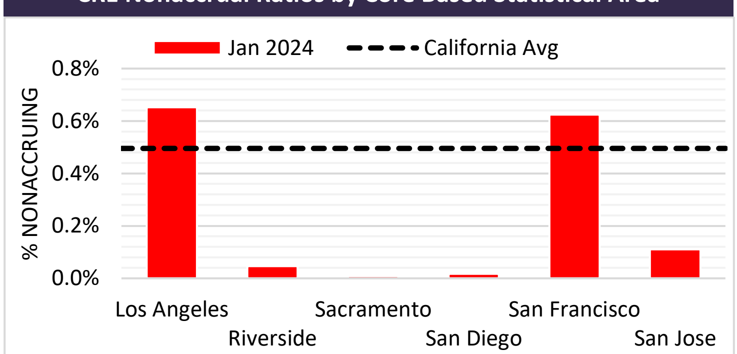
With the chart on the left, we are showing three key loan performance measures for C&I loans. Starting with March 2020, all three measures jumped in the first few months as the result of COVID closures and then receded towards the end of 2021. But since early 2023, the short-term delinquency and nonaccrual rates are trending back up. The double impact of high inflation and high interest rates on the cost structure of many debt-heavy industries has resulted in significant declines in performance. We're also seeing volatility with the short-term delinquency statistics as borrowers struggle with cash flow and debt repayment.

On the right we illustrate, for each of the eight major property types, the percentage of outstanding balances for borrowers that are rated the lowest passing grade on our standardized scale ("Low Pass"). We have observed over time that a large percentage of these credits tend to deteriorate further and become criticized. While problems with Office properties have been well publicized, almost 40% of Industrial is rated Low Pass, due in large part to a slowdown in the need for warehouses as the e-commerce growth rate has slowed.

CRE Low Pass-Rated Volume by Property Type



CRE Nonaccrual Ratios by Core Based Statistical Area



The Credit Risk Navigator database can provide performance results by the location of a borrower down to the Core Based Statistical Area (CBSA) level. By examining the results at this level, you can often see that performance can vary widely within certain regions or cities. The chart on the left shows the percentage of non-accruing balances for the major cities in California. The two largest cities, Los Angeles and San Francisco, have been experiencing higher levels of vacancies for Office properties, which is resulting in higher levels of nonaccruals as cash flow and net income declined.

Why RMA and AFS?

RMA and AFS are committed to providing relevant, timely, and practical credit risk solutions to banks. Combining the strengths of each to offer information and insight, RMA and AFS are ideally situated for collaborations aimed at identifying and responding to the credit risk needs of financial institutions.

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