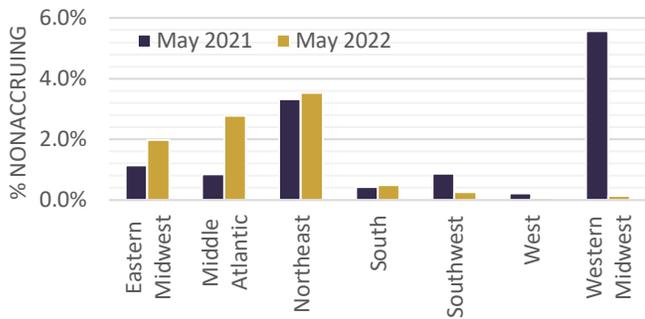


Amidst Mixed Macroeconomic Messages, Commercial Credit Quality Remains Sound

Commercial loan performance and credit quality remained sound through May 2022, as the U.S. economy throws off a remarkable combination of mixed signals. Consumer sentiment – as measured by the University of Michigan survey – slumped to a record low in June, and yet consumers are sitting on a stockpile of savings, wages are still rising, and a pullback in consumer spending has not yet materialized. The Fed has moved aggressively to tamp down inflation and cool the labor market, raising the federal funds rate 75 basis points this week alone, and yet wages continue to rise and job vacancies remain at historically high levels. The economy is clearly slowing – the Atlanta Fed’s GDPNow real GDP estimate for 2Q2022 stands at 0.0% as of this writing – and yet the vast majority of U.S. corporations, including financial institutions, report strong balance sheets and healthy profitability. Against this backdrop, the U.S. banking industry is entering this period of heightened uncertainty far healthier than it did in the years leading up to the Great Recession.

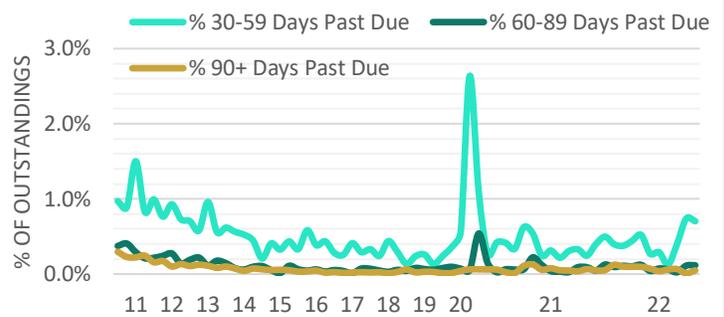
CRE Percent Nonaccruing Trend by Geographic Region



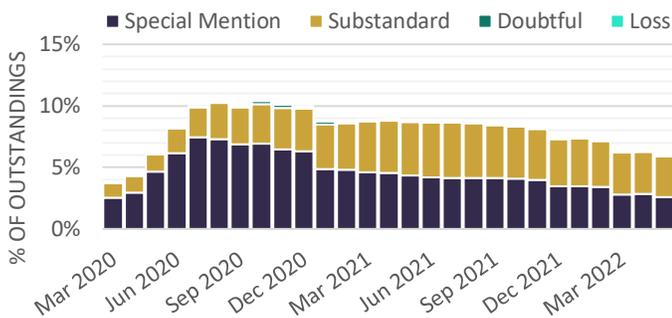
Past Due levels, especially 30–59 day delinquencies, often fluctuate, tending to be lower at quarter ends but much higher in the intervening months. For CRE loans, the delinquency rate reached a service low of 0.13% in June 2019, but then the initial shock of business closures due to COVID-19 pushed the past due level to 2.6% in 2020. By February 2022, on-time payments had improved, and early stage delinquencies were back to 0.13%. Since that low point, on-time payments have slipped for office and multifamily properties and land development projects, pushing the 30–59 day past due ratio back up to 0.70%.

For this month’s Commercial Credit Quality Bulletin we focus on the state of commercial real estate credit quality. For year-over-year nonaccrual levels by property location, we note dramatic changes for many geographic regions. In the western parts of the country, nonaccruals have improved for retail, hotel, and healthcare properties. However, the Middle Atlantic region has experienced a 3x increase from the year-ago level due to new problems with mixed-use properties and an increase in nonaccruals for hotels. The overall nonaccrual level for commercial real estate credit remains well above pre-pandemic levels.

CRE Delinquency Trend (Accruing Loans)



CRE Criticized Loan Trend



While recent CRE performance is mixed, overall portfolio quality, as measured by the percentage of loans risk rated as criticized, remains sound. At the end of March 2020, the overall percent criticized rate was just under 4%. By mid-summer, banks downgraded a large portion of the portfolio to Special Mention, pushing the percent criticized rate to a cycle high of 10.44% in October 2020. Since that time, banks have gradually re-rated, sold, or charged-off most of the adversely classified loans, and the overall percentage of criticized loans to total CRE loans is about half of the pandemic high water mark.

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.

Tom Cronin, AFS, tcronin@afsvision.com • Carly Edmondson, RMA, cedmondson@rmahq.org

www.afsvision.com • www.rmahq.org