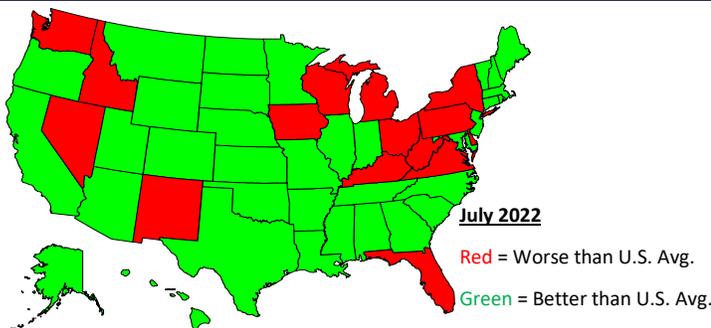


While Fed Moves Aggressively to Curb Inflation, Commercial Loan Credit Quality Holds Steady

Bank commercial credit quality remained strong through July, with many key indicators of credit risk remaining at or near cycle lows. C&I loans on nonaccrual totaled just 0.52% of total loans, even lower than pre-pandemic averages. The one area to keep an eye on is short-term (30–59 day) delinquencies, which continued their volatile march throughout 2022, spiking to 0.97% of total loans at July month end. The Fed has aggressively raised interest rates to combat entrenched inflation, raising rates 225 basis points since March to reach neutral territory, with expectations to be in restrictive territory by the end of the year. While the boost in rates has given banks a notable increase in interest income, the rapid pace of rate increases will inevitably strain borrower cash flow and increase credit risk across most asset classes. Despite these concerns banks have not materially altered risk ratings yet, although a notable percentage of banks have moved to tighten underwriting standards according to the latest Senior Loan Officer Survey from the Fed.

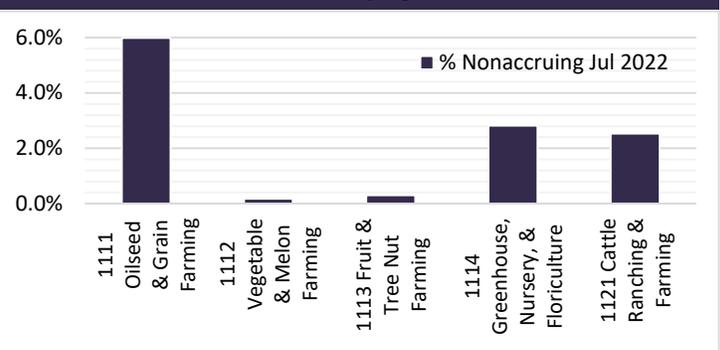
C&I Nonaccrual Ratios – By State



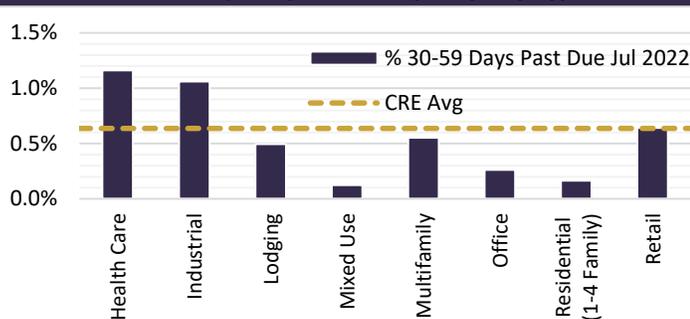
Widespread drought and high inflation have severely impacted the Agriculture industry, pushing its nonaccrual level higher than any other industry. The current U.S. drought picture is labeled as ‘Exceptional’ in Texas and California to ‘Extreme to Severe’ in many places in between, and now ‘Moderate to Severe’ in the New England states. An American Farm Bureau Federation survey is estimating a 38% drop in revenue for U.S. farms as a direct result of the 2022 drought. Inflation is driving up prices, leading farmers to struggle with an increase in expenses while facing a corresponding drop in revenue.

The percentage of C&I loans on nonaccrual dropped again in July month over month. The improvement has been widespread throughout most industries and throughout most of the country as strong employment and a slight easing in gas prices have provided tailwinds to the economy. There are a few pockets of the country that are still experiencing elevated nonaccrual levels. Several Midwestern states are showing elevated levels due to problems with Agriculture and Manufacturing. Agriculture is a significant problem in the Northwest and Pennsylvania, while manufacturing-related risk is surfacing in New York.

C&I Nonaccrual Ratios – By Agriculture Subsectors



CRE Delinquency Ratios – By Property Type



Short-term delinquencies for Commercial Real Estate loans are back above pre-pandemic levels, with Healthcare and Industrial properties far above the overall average. For Healthcare, nursing and long-term care facilities are still subject to higher levels of vacancies. Even before COVID, occupancy levels in these facilities were dropping. As a result of the large percentage of COVID-related deaths, occupancy levels have dropped even further causing concerns about future cash flow and debt service ability. In addition, the restrictions on elective surgeries impacted the need for rehab services.

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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