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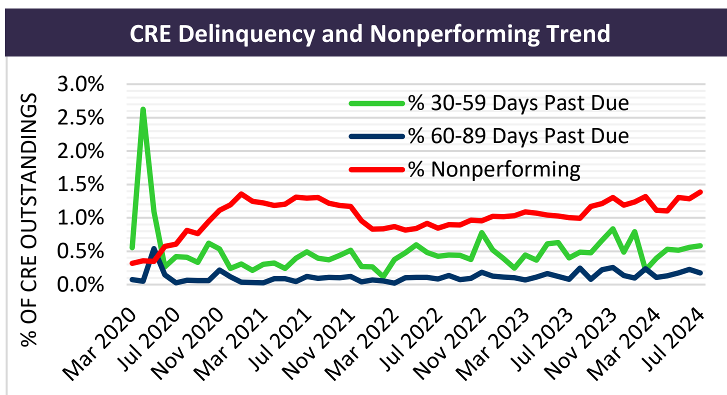
Risk Management Association

Commercial Credit Quality Bulletin

August 2024

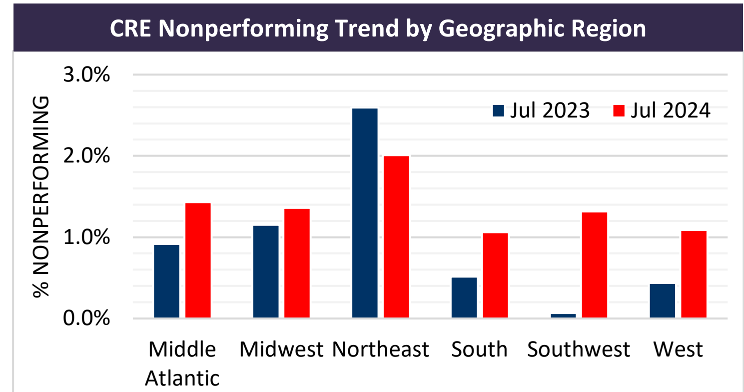
Labor Market Disappoints in July; How Long Will Commercial Credit Quality Hold Up?

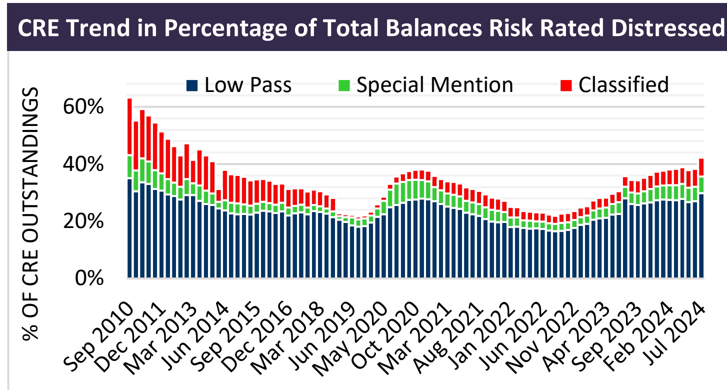
July's results for both U.S. job growth and unemployment were worse than expected, prompting a severe selloff in equities early in August and raising fresh concerns about whether the Fed can achieve a "soft landing." Markets are anticipating that the Fed will cut interest rates in September, perhaps the first of many that would relieve stress on business borrowers struggling to pay high interest loans. Through July, C&I credit quality remained stable outside of isolated issues in the health care and transportation sectors. By comparison, the percentage of CRE loans continues to normalize higher. Office remains the major source of stress in the CRE space. Amid recent economic data, our focus will shift to the timing and magnitude of a Fed pivot and its ultimate impact to borrower cash flow and loan performance.



The chart on the left displays three key risk indicators for commercial real estate loan performance – the percentage of loan outstanding balances 30–59 days past due, 60–89 days past due, and nonperforming (the latter being loans 90+ days past due plus loans on nonaccrual). The chart illustrates the trend in performance since March 2020. You can see the initial spike and decline in performance related to business closures and reduced occupancy due to COVID early on in 2020. After most of the restrictions were lifted, the performance improved. But most recently, we're seeing another slow but steady decline in performance, and we have reached a level that we haven't seen since 2014.

The chart on the right shows the percentage of nonperforming commercial real estate loans dimensioned by the location of the property. Here we are comparing the year-over-year performance from July 2023 to July 2024. The worst performer, the northeast region, has improved year over year due to improvement with Lodging properties. But the South, Southwest, and West have experienced significant declines. Within these three regions, we're seeing substantial declines in performance in Louisiana, Colorado, Utah, Texas, California, Oregon and Washington, with Office properties being the most impacted.





With the chart on the left we illustrate a trend in commercial real estate loans with marginal to weak borrower risk ratings. We list loans to borrowers with the lowest passing grade (Low Pass), Special Mention loans, and Classified loans (loans rated substandard, doubtful, or loss). This total combination we refer to as distressed commercial real estate loans. Similar to what we have seen with the nonperforming CRE loans, the percentage of distressed loans has increased significantly over the past 18–24 months and is now at an 11-year high. Leading the way with high levels of distressed loans are Office, Lodging and Industrial properties.

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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