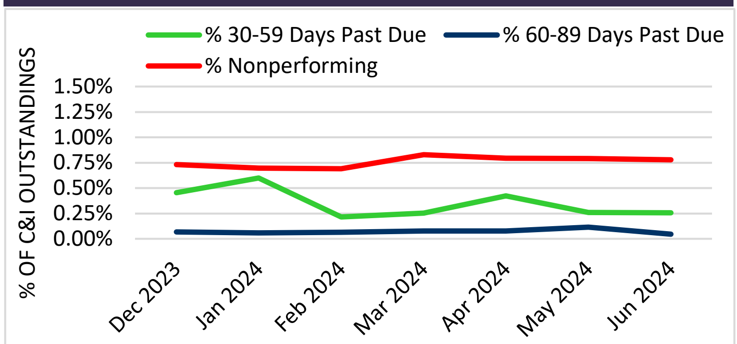
Commercial Credit Quality Bulletin

July 2024

Commercial Credit Quality Broadly Steady Amid Macro Uncertainty, Expected Inflection in Interest Rates

High interest rates, new economic and political uncertainty, and weak loan demand remain headwinds for banks through the halfway mark of 2024. Despite a prolonged period of high inflation and interest rates, commercial credit quality has largely avoided some of the more pessimistic forecasts. The percentage of C&I and CRE borrowers categorized as "nonperforming" has stabilized in recent months, reflecting bank efforts to shed distressed portfolios, tighten underwriting standards on new deals, and maintain a generally risk-averse environment. However, souring office loans and stress in the transportation and health care sectors have prompted banks to continue to build loan loss reserves. The future path of interest rates will greatly influence whether these areas of weakness develop into deeper problems.

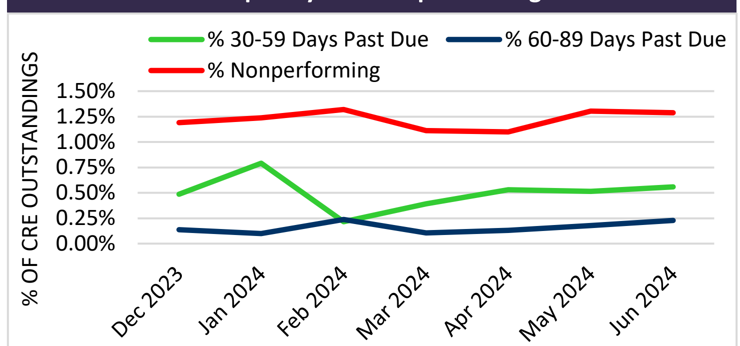
C&I Delinquency and Nonperforming Trend



The chart on the left shows the performance results for the first half of 2024 for the Commercial and Industrial (C&I) portion of the portfolio. Both the short term (30–59 days) and medium term (60–89 days) past due measures have gradually improved over the past six months. However, the Nonperforming measure (loans 90+ days past due plus loans on nonaccrual) has slowly drifted upward, from 0.73% as of December 2023 to 0.78% as of June 2024. The semi-annual comparison reveals a significant increase in the nonperforming level for NAICS 11 – Agriculture and NAICS 49 Warehousing, but both of these increases appear to be very localized to California and Michigan, respectively.

The chart on the right shows the performance results for the first half of 2024 for the Commercial Real Estate (CRE) portion of the portfolio. When compared to the end of 2023, all three measures are showing increases as of June 2024. Short term past dues are up slightly. Medium term past dues are nearing 0.25%, almost doubling where they were six months ago. The overall nonperforming level is now above 1.25%. As well documented, we are seeing substantial increases in the nonperforming level for Office properties. And we are also seeing increases for several other property types, notably Lodging, Residential and Retail.

CRE Delinquency and Nonperforming Trend



% Expecting Deterioration in CRE Credit Quality Over Next 6 Months

82%

During the June 2024 RMA/AFS Credit Trends webcast, we asked the attendees "What are your expectations for credit quality for the second half of 2024?" As shown on the left, an overwhelming majority (82%) believed that CRE credit quality would deteriorate further throughout the remainder of the year. This expectation continues the trend that we are seeing in the first half of 2024. CRE Loans rated Special Mention increased 21 bps, while loans rated as Classified (Substandard, Doubtful and Loss) jumped 110 bps since December 2023. The largest increase in Classified has been for Multifamily 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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