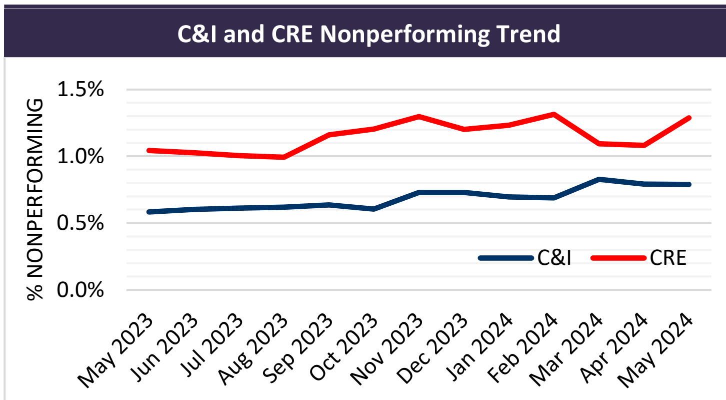
Commercial Credit Quality Bulletin

June 2024

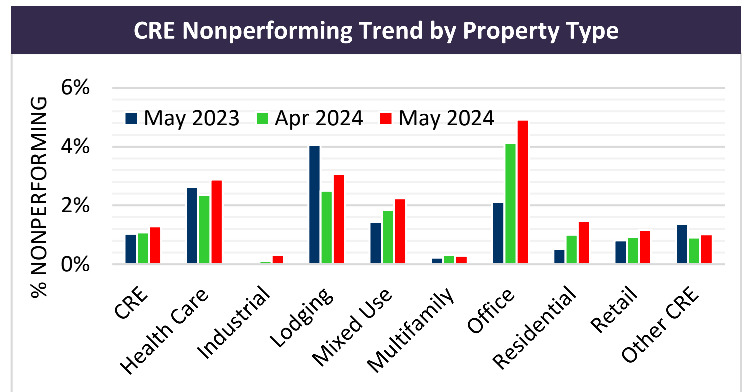
C&I Loan Performance Stabilized in May While Office Challenges Drove CRE Nonperforming Loans Higher

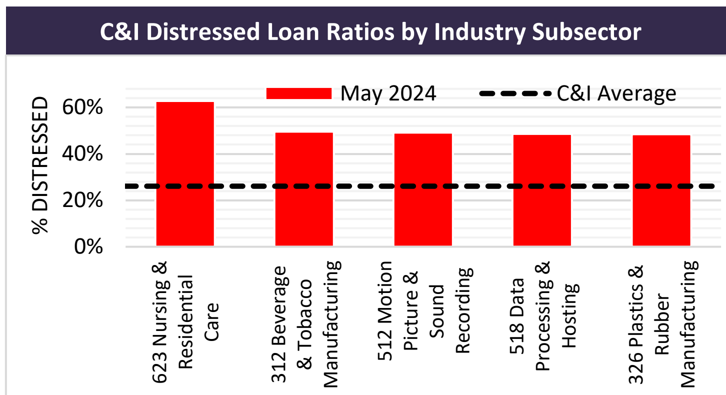
Concerns about commercial real estate asset quality – particularly loans backed by office properties – continue to dominate financial headlines and have adversely impacted the stock prices of several regional banks deemed to have concentrations of credit. The percentage of CRE loans categorized as nonperforming jumped 21 basis points from April to May, representing the largest monthly increase seen since June 2020. While the office sector was the primary culprit, the magnitude of the deterioration was highly variable when viewed across individual banks. C&I credit performance was stable month over month in May but weakened when compared to the year-ago levels. The credit outlook for the remainder of the year remains clouded by stubborn inflation, a slowing economy, and escalating CRE maturities.



"Nonperforming" includes loans on nonaccrual as well as accruing loans past due 90 days or more. The ratio of C&I loans categorized as nonperforming varied little in May from the prior month but deteriorated 20 basis points versus the year-ago level. Stubborn inflation and high borrowing costs remain a burden for many business borrowers, particularly the smaller-end credits that lack access to capital markets. For CRE loans, the nonperforming rate rose 21 basis points from April to May, the largest monthly increase seen since June 2020. While the office sector remains the primary source of credit distress in the CRE space, credit quality for office loans is highly variable when viewed across banks.

From April to May, nonperforming CRE loans were up across every major property type with the exception of multifamily. Office led the increases, with nonperforming loans more than doubling for this sector on a year-over-year basis. Valuations for multi-family and industrial properties remain robust, with the former benefitting from high mortgage rates and the latter buoyed by demand for manufacturing and data centers. The "true" level of nonperforming CRE loans may be higher than the figures indicated in the adjacent chart, as banks have modified terms and/or extended maturities for a sizeable number of stressed CRE borrowers.





Restrictive monetary policy, particularly higher-for-longer interest rates, have tamped down demand for new credit while simultaneously straining repayment capacity for debt-heavy borrowers. With inflation remaining well above the Fed's two-percent target, relief in the form of interest rate cuts remains uncertain in terms of timing and magnitude. Thankfully, problem credits in the C&I space are limited to a handful of sectors. The adjacent chart depicts the C&I industries with the highest "distressed" ratios, representing loans risk rated low pass or criticized. Among the at-risk areas are two manufacturing-related industries.

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