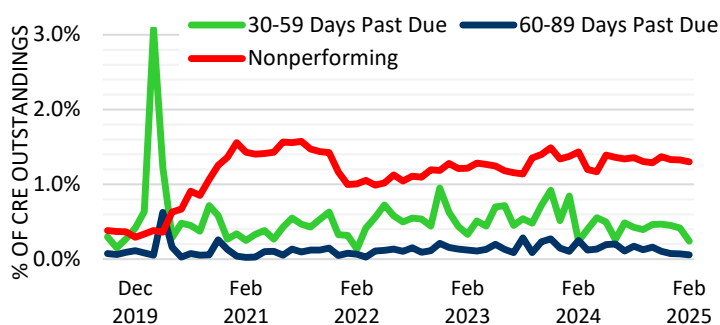


U.S. Economic Indicators Raising Red Flags as Banks Navigate Trade Policy Uncertainty

The surge in business optimism that followed November's elections is rapidly giving way to concerns about tariffs and their impacts on inflation and business investment. Consumer spending – which proved resilient in recent years despite surging inflation and interest rates – appears to be weakening, leading the Fed to downgrade its collective outlook for economic growth. Uncertainty surrounding trade policy has compelled banks to examine their exposure to industrial and consumer products, automotive, and other tariff-sensitive industries which RMA and AFS conservatively estimate as representing nearly a quarter of total C&I loans outstanding. In the CRE space, credit quality concerns are broadening beyond the beleaguered Office sector, with distressed levels for loans backed by Industrial and Multifamily properties beginning to rise. The potential for a prolonged period of economic volatility promises to test banks' adaptability and risk management capabilities.

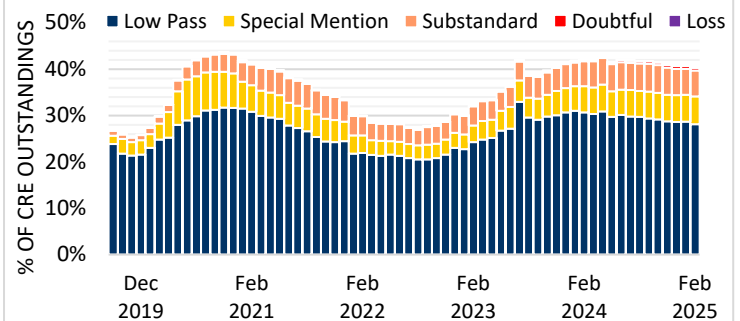
CRE Delinquency and Nonperforming Trend



On the left we show our three measures of loan performance for the Commercial Real Estate portfolio. The chart shows the service history for short term past dues, medium term past dues and nonperforming loans, which are loans that are 90+ days past due plus loan that are in a nonaccrual status. Recently, both past due measures have been relatively flat after being close to service highs throughout most of 2023. The nonperforming levels have been a little more volatile, especially since the advent of the pandemic. We saw sharp increases in 2021 followed by a slight recovery in 2022 and then another deterioration the next year. For most of the past 10 months the level has been hovering around 1.30%.

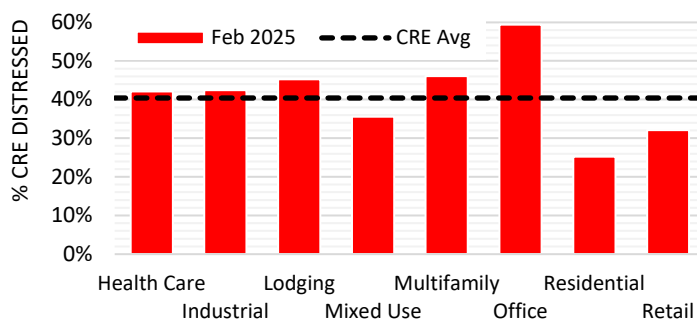
The chart on the right shows the trendline for our credit quality measure, distressed volume. We combined balances from borrowers that are risk rated Low Pass with balances from borrowers that are rated Criticized and label that group "distressed". This grouping represents balances that are experiencing above average stress and are more likely to default. Before the pandemic, the credit quality outlook for CRE was at a CRN program best. Since then, we have experienced three significant trends – a decrease in quality as the % Distressed surged upward in late 2020, an improvement by the end of 2022 and more recently another deterioration where distressed levels have leveled off near 40% of total balances.

CRE Distressed Volume Trend



Here we have the % Distressed for each of the eight major property types for the CRE portfolio. It has been well publicized in banking and business publications that hybrid work schedules and slow Return-to- Office rates have negatively impacted credit quality for Office. In a new development, the second worst property type in terms of credit quality is now Multifamily. This is due almost entirely to an overbuilding of properties with more amenities and high-end construction finishes, which command a higher rent. With higher-for-longer rates and stubborn inflation, vacancies for these high-end apartments are climbing and NOI has decreased.

CRE Distressed Loan Ratios by Major Property Type



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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