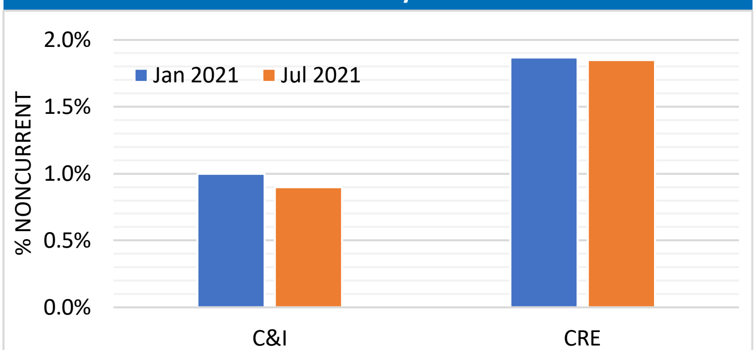
Commercial Credit Quality Bulletin

August 2021

Credit Recovery Inches Along but Commercial Real Estate Asset Quality Lags C&I by a Wide Margin

While the search for green shoots in commercial loan growth garners the headlines, banks generally continue to report improvements, although modest, in commercial credit quality. Noncurrent C&I loans, defined as those loans on nonaccrual or past due 90 days or more, totaled 0.90% at the end of July, down 10% in the last six months. Noncurrent Commercial Real Estate loans, on the other hand, remain stubbornly high, registering 1.85% through July, nearly unchanged from the six-months ago figure (1.87%). Despite widely successful government stimulus and regulatory forbearance and deferral programs, problems within the lodging industry have been the biggest culprit constraining a stronger recovery. Muted business and leisure travel is still holding back a more robust recovery in hotels. And while office Commercial Real Estate is holding up, the long-term nature of leases and the ongoing rationalization of corporate real estate needs by many companies may postpone the surfacing of weaknesses for some time to come.

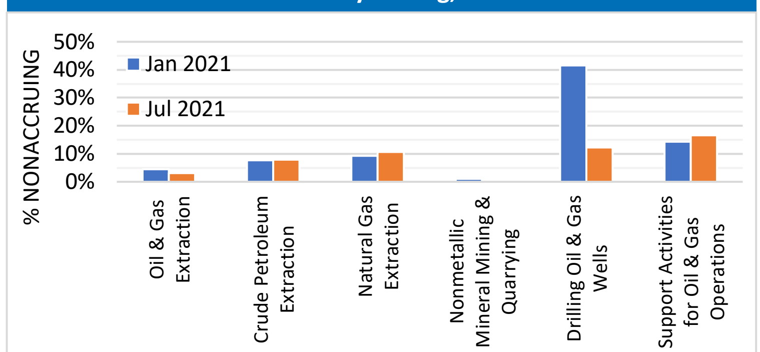
Noncurrent Trend – By Line of Business



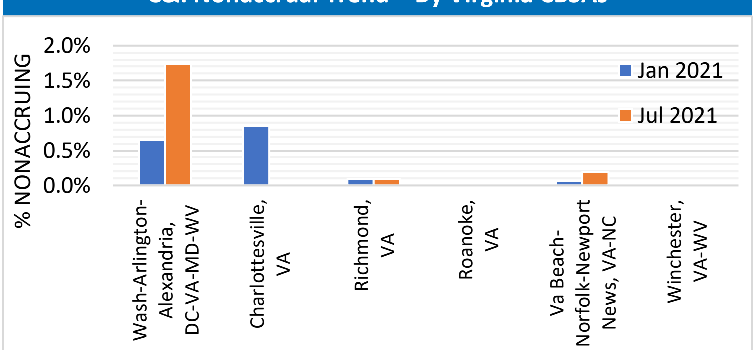
Improvements in C&I loan quality have been slow, but steady. For example, the percentage of criticized C&I loans – or loans rated Special Mention, Substandard, Doubtful, or Loss – has declined for 10 consecutive months, from 8.6% as of September 2020 to 7.1% as of July 2021. And while Commercial Real Estate credit quality ratios have not deteriorated further from the cycle highs we saw in the Fall of 2020, improvements have been slower to materialize when compared to C&I loans.

One sector that has shown improvement of late – but is not out of the woods – is Oil & Gas. Six months ago, nonaccrual loans in the sector totaled nearly 9%; at July 2021 month end that figure is down to 6.1%. Leading the improvement have been the Upstream/E&P and Oilfield Services verticals, specifically Oil & Gas Extraction and companies involved in the Drilling of Oil & Gas wells (right hand chart). So while labor shortages and other remnants of the pandemic persist, the industry is making strides to recovery.

C&I Nonaccrual Trend – By Mining, Oil & Gas Subsectors



C&I Nonaccrual Trend – By Virginia CBSAs



Over the last six months, six of the seven major geographical regions we track showed improvements in non-accruing loan balances. The only exception was the Middle Atlantic region, which saw non-accruing loan levels increase from approximately 0.8% to just over 1.0%. The bulk of the increase was seen in the state of Virginia. The chart on the left depicts a six-month change in nonaccrual levels for some key core based statistical areas in the state of Virginia.

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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