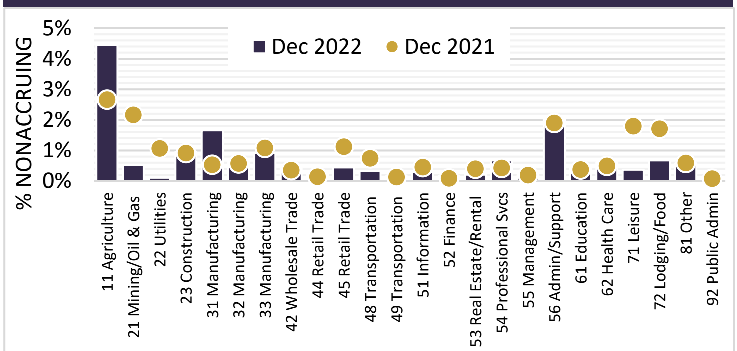
Commercial Credit Quality Bulletin

January 2023

C&I Loan Quality Pristine, Commercial Real Estate Worth Watching Entering a Year of Heightened Uncertainty

Overall bank commercial credit quality remained sound through year end 2022. Levels of regulatory criticized loans – loans rated either special mention, substandard, doubtful, or loss – registered 4.5% and 6.6% for C&I and CRE loans, respectively, down from 5.8% and 7.4% from the year-ago period. C&I short-term delinquencies remain well contained, with loans past due one payment near historic lows at 0.22%. We continue to track CRE loan performance closely. Total past due and nonaccrual CRE loans represented 1.8% of total CRE loans at year end, an increase of 34% in the fourth quarter and about 15% above the three-year rolling average. A softening economy entering 2023 will lead to further normalization of credit costs, with consensus projections calling for a mild recession in the second half of the year.

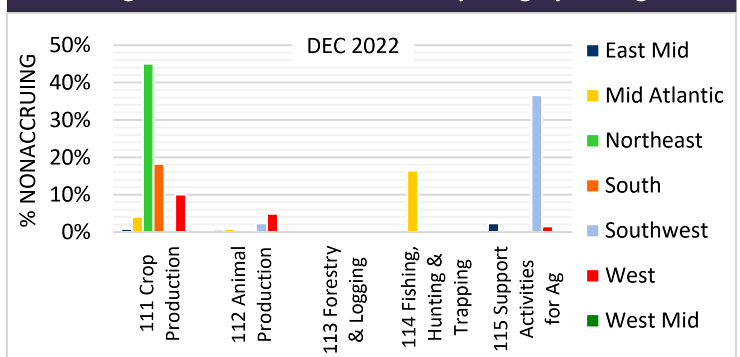
C&I Nonaccrual Trend by Industry



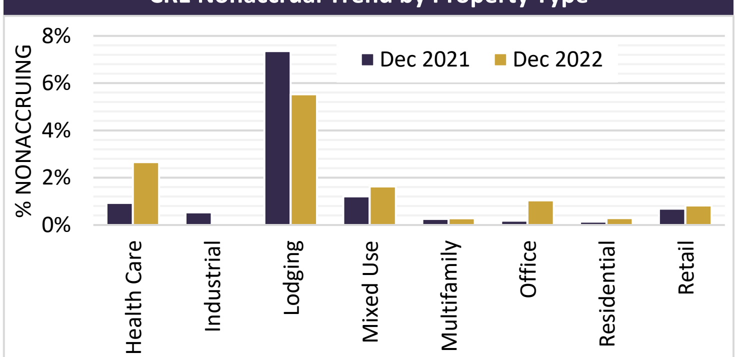
The chart to the left compares industry sector nonaccrual rates for December 2021 versus December 2022. With a few exceptions, the December 2022 results show an improvement over the prior year. The most notable changes were for Mining, Oil, & Gas; Arts & Entertainment; and Accommodations. All three improved over 100 basis points each as they continue to rebound from the pandemic-induced downturn. Agriculture on the other hand is up almost 200 bps year over year as profitability has been impacted by drought and higher expenses.

On the right we take a closer look at nonaccrual rates within the Agriculture (AG) industry, segmented by five Ag subsectors and then by geographical region. The Forestry, Fishing and Support subsectors tend to have fewer and more isolated problems when compared to the Crop and Animal Production subsector. The Animal Production defaults are a little more nationwide. But the most pervasive defaults are occurring within Crop Production. Defaults have surfaced in five of the seven regions, and three of the regions have nonaccrual levels north of 10% as growers fight high costs and reduced yields.

C&I Agriculture Nonaccrual Ratios by Geographic Region



CRE Nonaccrual Trend by Property Type



On the left we are showing nonaccrual levels for major Property Types in the investor Real Estate portfolio. Similar to the first chart, we are comparing the levels for December 2021 vs. December 2022. You can easily see the big improvement for Lodging as the convention business is rebounding and business as well as personal travel is nearing pre-COVID levels. Unfortunately, this improvement is being offset by increases in defaults for Healthcare (primarily Nursing Homes), Mixed Use, Office and Retail 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.

Tom Cronin, AFS, tcronin@afsvision.com ● Carly Edmondson, RMA, cedmondson@rmahq.org

www.afsvision.com ● www.rmahq.org