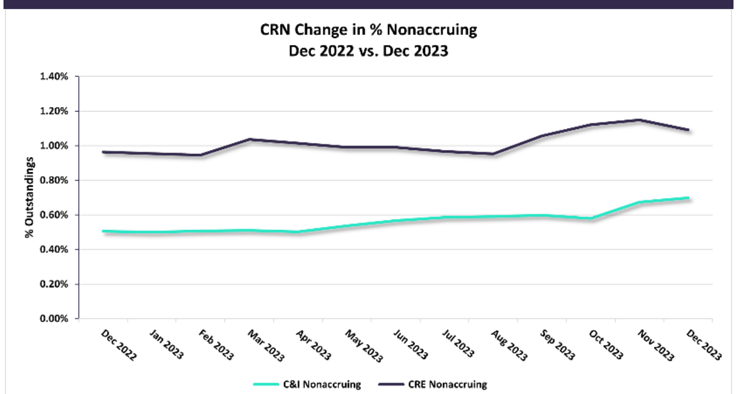
Commercial Credit Quality Bulletin

January 2024

2023 Commercial Credit Quality Remains Resilient But Continued Normalization Likely in 2024

2023 can be characterized as a year of gradually weakening commercial credit quality. While borrower performance has remained largely resilient, the full effects of the Fed's historic rate tightening cycle have almost certainly not been fully felt throughout the economy. Commercial and Industrial (C&I) and the Commercial Real Estate (CRE) loan outstanding balances on nonaccrual ended the year at 0.70% and 1.1%, respectively, compared to 0.51% and 0.96%, respectively for the year ago period. Banks have aggressively built reserves and shed nonperformers throughout the year and remained largely risk averse and selective in terms on onboarding new commercial borrowers. Despite an expected Fed pivot in 2024, further normalization is expected throughout the year and growth forecasts are more in line with broader economic growth expectations.

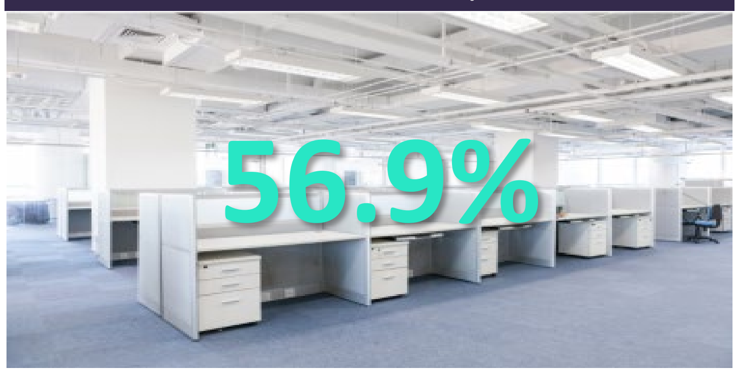
C&I and CRE Delinquency and Nonperforming Trend



With the chart on the left, we are showing the 2023 trend in % Nonaccruing (amount of loans on nonaccrual status divided by the total outstandings) for the C&I and the CRE portfolios. Throughout most of 2022, we saw a substantial recovery from the impacts of the pandemic. However, since the end of 2022, the year-over-year trend is not favorable for either portfolio. An increase in nonaccruals for Office properties was the primary reason for the CRE increase. For C&I, we saw deterioration for several industry sectors that we'll discuss in the January webcast.

On the right we are looking at the % Distressed for Office. In CRN, borrowers are assigned a risk rating based on the RMA 10-point scale. On that scale, borrowers rated 6 are Low Pass, and any higher rated borrowers are Criticized. We combine Low Pass and Criticized into a category we call Distressed. As of December 2023, almost 60% of the outstandings to borrowers that are financing Office properties are distressed, experiencing some sort of financial difficulty. The historic high in vacancies due to the slow return to office is causing cash flow issues for many office properties and overall Office credit quality is poor.

% Distressed – Office Properties



CRE Performance Scorecard by Property Type

Property Types	30-59	60-89	Non
Health Care	0.29%	0.62%	2.73%
Industrial	0.27%	0.01%	0.17%
Lodging	0.87%	0.03%	2.51%
Mixed Use	0.54%	0.27%	1.81%
Multifamily	0.51%	0.06%	0.39%
Office	0.66%	0.06%	4.25%
Residential	0.46%	0.30%	0.46%
Retail	0.42%	0.22%	0.78%

On the left is our Performance Scorecard for facilities financing major CRE property types. In the columns to the right of the Property types, we are showing the rankings for 30–59 days delinquent, 60–89 days delinquent and % Nonaccruing. The cells colored green represent the best results (the best quartile), the yellow-colored cells are the average or the middle two quartiles, and the red colored cells are in the worst quartile. Industrial properties are performing the best. As noted above, Office properties are in the bottom quartile for two of the three measures, as are Health Care 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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