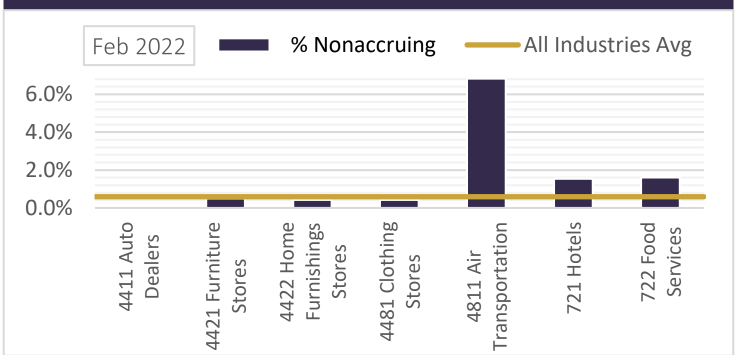
Commercial Credit Quality Bulletin

March 2022

Commercial Credit Quality Remains Stable through February amidst Economic Cross Currents

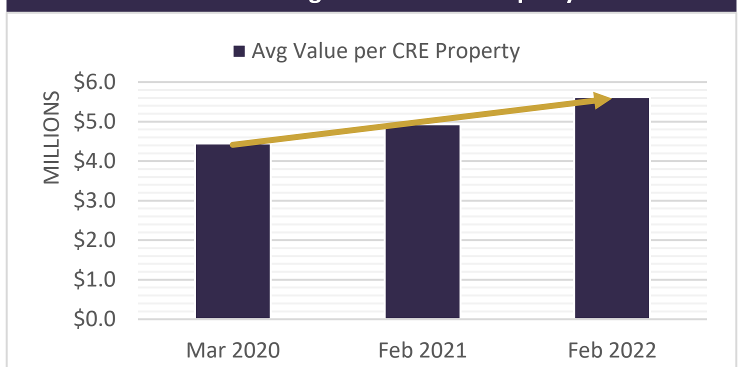
Commercial loan performance and credit quality remained sound through February 2022. Key credit risk indicators including short-term delinquency ratios, levels of defaulted or “nonaccruing” loans, and criticized asset ratios continue to trend downwards and/or remain stable. Nonetheless, we continue to track several recent developments that have rattled U.S. markets, which could influence this credit cycle, including Russia’s invasion of Ukraine and persistently high inflation. Most North American banks have little to no direct exposure to Russia; however, the longer the conflict drags on certain indirect risks could start to effect the U.S. banking sector. Rising commodity prices, challenges in the sourcing of raw materials, and further delays in the resolution of certain supply chains are examples of indirect or second-order impacts to U.S. corporations and their sales and profit margins. On the inflation front, the Federal Reserve began a tightening cycle in March and signaled their intentions to raise rates at each of their six remaining meetings this year.

C&I Nonaccrual Rates for Inflation-Sensitive Industries



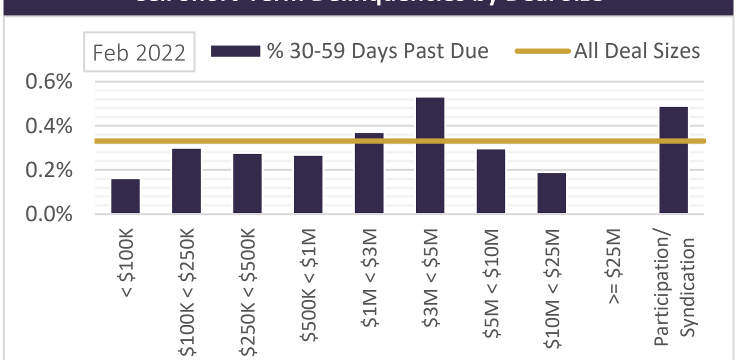
As increases in costs for gas, food, housing and other essentials absorb more of the average consumer’s paycheck, spending for luxuries will likely recede. Industries that will be most impacted by changing spending habits are categorized as Consumer Discretionary, and the current state of some key sectors is shown on the left. An extended period of high inflation would be detrimental to these sectors, some of which are already performing worse than average.

CRE Trend in Average Commercial Property Value



Fueled by low interest rates and intense competition, the U.S. commercial real estate market has experienced a sharp rise in prices. The average LTV in our CRN database has dropped over the past couple of years, although this favorable decline is due more to rising property values as opposed to declining balances in CRE loans. Since early 2020, the average property value in CRN has jumped approximately 25%, led by increases in multi-family.

C&I Short-Term Delinquencies by Deal Size



Short-term delinquency levels for smaller loans are now better than they have been historically. The government stimulus programs propped up this sector significantly in 2020–2021, but now the change appears to be the result of a shift in industry mix. Compared to what we saw after the 2008 recession, banks have limited their small business lending to industries that are less risky and tend to perform better. This de-risking has led to better credit quality for the smaller loans.

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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