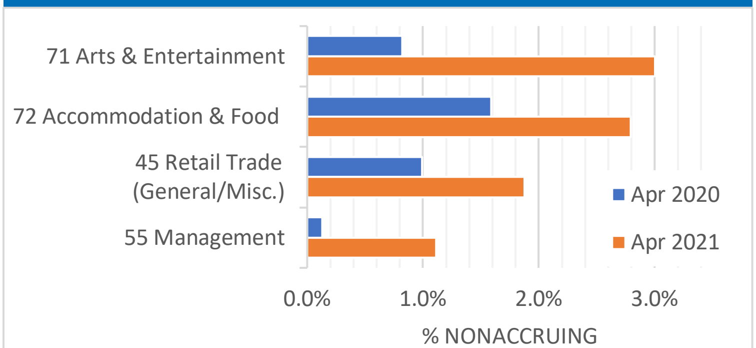
Commercial Credit Quality Bulletin

May 2021

C&I Loan Underwriting Standards Ease but Demand Subdued: Credit Quality Holding Steady

Most of the overall economic news for 2021 has been very favorable – GDP for the first quarter of 2021 was up 6.4%, sales of new homes were over one million units in March 2021, the industrial production index for April was up 0.7%, and consumer spending was up almost 11% in 1Q2021 compared to 4Q2020. However, C&I borrower performance, as measured by delinquencies and nonaccruals, and commercial credit quality and migration, as measured by the risk rating distribution, has yet to show much improvement. Short-term delinquencies (30–59 days past due) climbed in April to 0.47%. The level of nonaccruing loans for April was 0.94%, little changed from six months ago. Loans rated Special Mention, Substandard, Doubtful, and Loss total 8.2%, well above the pre-pandemic, December 2020 level of 5.75%. A majority of the delinquencies and nonaccruals are concentrated in just a few industries, such as fitness centers and bars.

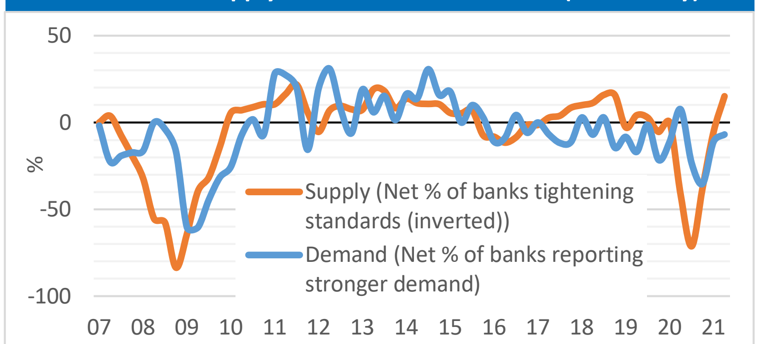
C&I Change in Nonaccrual Ratio – By Selected Industries



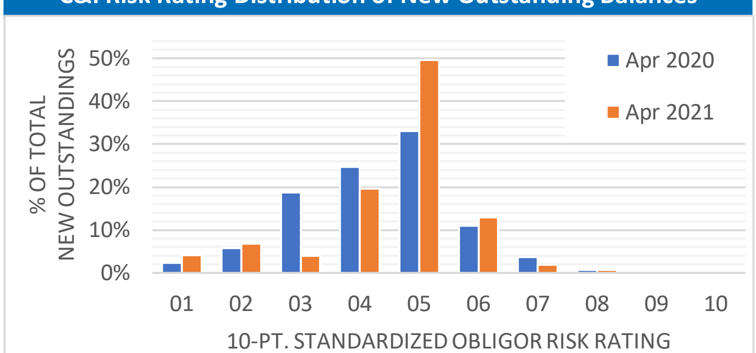
Small cohorts of commercial loans exhibited significant increases in their nonaccrual ratios over the past year, having been particularly impacted by the restrictions put in place to combat COVID-19. The Arts & Entertainment sector and the Accommodation & Food sector had April 2020 vs. April 2021 changes over 200 basis points. Within the Arts sector, Fitness Centers experienced the largest decline, and within Accommodation, Drinking Places and Restaurants saw sharp increases in nonaccrual levels. The increase in Retail was primarily for Direct Selling Establishments, such as coffee supply vendors.

In the Federal Reserve April 2021 Senior Loan Officer Opinion Survey of Bank Lending Practices, respondents indicated that standards for commercial and industrial loans were eased in the face of the improving economic outlook. The orange line (chart on right) labeled Supply represents banks' willingness to lend, and when it is above 0 this indicates a net loosening of standards to entice borrowing. The blue line, labeled Demand, represents customers' perceived desire to borrow. When it is below 0, this tells us that borrowers remain on the sideline.

Measures of Supply & Demand for C&I Loans (Fed Survey)



C&I Risk Rating Distribution of New Outstanding Balances



On the left, we present an industry-normalized borrower risk rating distribution along a 10-point scale. Here we are comparing the risk rating of the new loans made in April 2020 with the risk rating of new loans made in April 2021. In April 2020, over 50% of the new loans made to borrowers were risk-rated 1 through 4, the best ratings. This April, loans to that category of borrowers amounted to just 35% of all new loans, as loans to average and low-pass borrowers (those rated 5 and 6) climbed to 63% of all new loans, reflecting both changing risk appetite but also loosening in underwriting.

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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