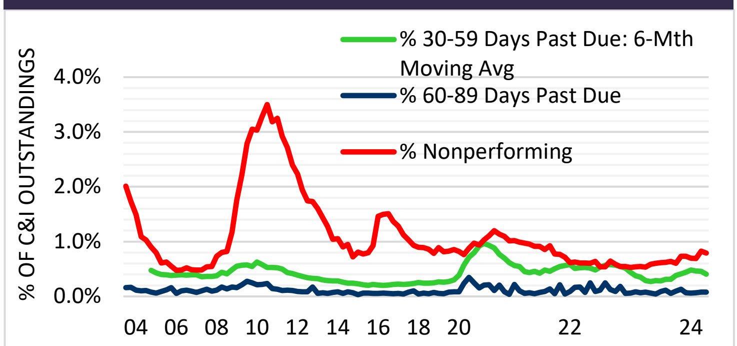
Commercial Credit Quality Bulletin

May 2024

Higher for Longer Interest Rate Expectations amplify concerns about Commercial Loan Performance

Key performance indicators for commercial loan performance and credit quality remained mixed through April, as higher-for-longer expectations for interest rates amplify concerns about borrower performance. While past due and non-accruing loan levels moderated (below), criticized loan levels continued their upward trajectory. The US banking industry built loan loss reserves for the eighth consecutive quarter, although the pace of increases moderated. Concerns on commercial real estate office and consumer portfolios accounted for most of the negative sentiment. U.S. corporate bankruptcy filings reached their highest level in one year in April, with the consumer discretionary, healthcare, and industrials sectors accounting for most of the volume. Conversely, inflation cooled in April for the first time in months.

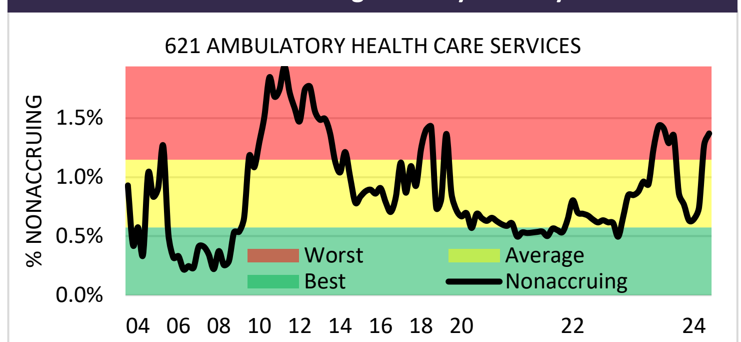
C&I Delinquency and Nonperforming Trend



With the chart on the left, we are showing three key loan performance measures for commercial and industrial (C&I) loans over the 20+ years of the Credit Risk Navigator program. The nonperforming metric combines loans that are 90+ days delinquent with loans that are in a nonaccrual status. The green line shows the six- month moving average for loans that are 30–59 days delinquent. All three measures have moderated this month, reversing a trend over the past twelve months during which nonperforming loans have increased from .53% to .83% and short-term delinquencies have risen from .29% to .40% as high inflation and interest rates have negatively affected borrower performance.

On the right, we are analyzing the nonaccruing trend for the Ambulatory Health Care Services subsector (NAICS 621) of the broader Healthcare industry. This subsector comprises enterprises such as doctor's offices, medical labs and outpatient care centers. The chart is divided into three categories, all based on historical results – the red represents the worst performance quartile, the green is the best, and the yellow represents the middle quartiles. NAICS 621 is again showing historically high non-accruing results as labor shortages and low reimbursements drain profits.

C&I Nonaccruing Trend by Industry



% of Banks Extending Maturity Dates on Modified CRE Loans

65%

During the April 2024 Commercial Trends webcast, we asked the attendees how frequently their bank was modifying stressed Commercial Real Estate loans, and, if they were modifying any loans, what was the most frequently used modification method. Options were lowering the interest rate, extending the term of the loan, or delaying payments. The majority of the attendees reported that modifications were occurring infrequently, but when modifications did occur, 65% of the banks were extending the maturity date of the loan until borrowers can refinance at lower rates.

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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