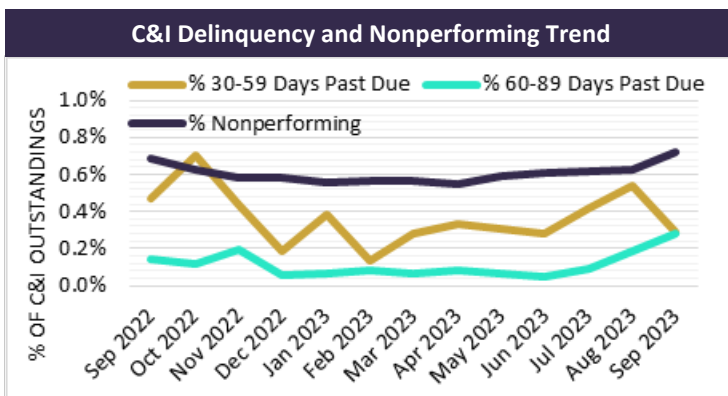


Commercial Loan Delinquencies Rise as Higher Interest Rate Environment Takes its Toll

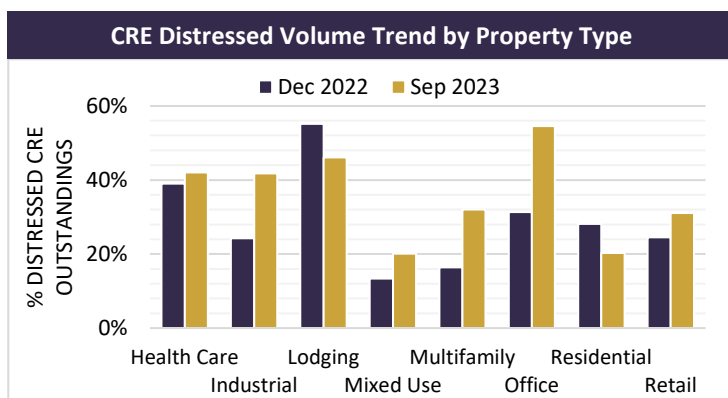
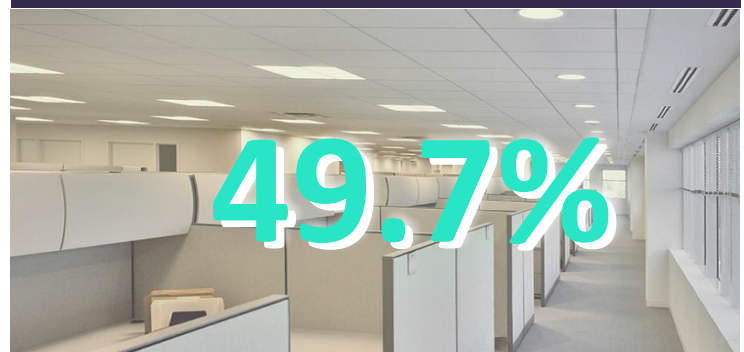
Key indicators of commercial credit performance remained solid through September 2023, although areas of concern are beginning to emerge. Commercial & Industrial (C&I) balances 60–89 days past due jumped to 0.28%, the highest ratio on record since May 2020. For contrast, the average past due ratio for the 60–89 days category over the last 12 months was only 0.10%. Noncurrent (nonaccrual +90 days) C&I balances represented 0.72%, up for the 5th consecutive month. Turning to Commercial Real Estate (CRE), noncurrent CRE loan balances represented 1.16% of total outstanding balances, the highest ratio in nearly two years. The higher interest rate environment is starting to have a more pronounced effect on borrower cash flow, and while the economy overall remains resilient, the backdrop is weakening.



The chart on the left shows the performance of the C&I portfolio over the past year. The portfolio had completely recovered from the pandemic shock and nonperforming loan levels were close to 0.50%. But that recovery has reversed course over the past several months as the combined impact of prolonged inflation and higher for longer interest rates is taking a toll on borrower cash flow. Nonperforming levels (nonaccruing loans 90+ days past due) have increased significantly. Higher expenses for materials and supplies as well as jumps in interest expense have cut into profits while highly leveraged firms in particular are experiencing distress.

The percentage on the right represents the outstanding balance of loans to finance Office properties that will mature within the next two years. Most of these loans were made five years ago when the Prime Rate was in the 4–5% range and now will need to be renewed with Prime at 8.5%. The new interest cost will severely impact the NOI for many properties that are already dealing with reduced income due to high vacancies as return to office levels have stalled. In addition, almost 60% of these loans are rated borderline pass or worse, making refinancing even more costly.

CRE Office Properties Maturing Within the Next Two Years



The chart on the left compares the percentage of balances to borrower's risk rated low pass and criticized (special mention, substandard, doubtful, and loss) for eight major property types in December 2022 compared to September 2023. Except for Lodging and Residential, the credit quality outlook for all CRE has declined. Led by the well-chronicled issues of Office properties, the RMA/AFS Credit Risk Navigator data is also showing an increase in distressed loans for Healthcare and Industrial properties. We also note a decline in the credit quality of Multifamily properties as a large amount of units come online.

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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