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# Saltmarsh BankChat: Trends & Expectations of Increasing Credit Risk in 2024

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# Credit Risk...where have you been?

- We've been through a long “bull” credit market, with remarkably low charge-offs, historically low problem loans and nonaccruals
- For the past couple of years, analysts and industry experts have consistently predicted worsening credit metrics, but so far, those predictions have been premature...but it does feel like we are just putting off the inevitable...
- The implementation of CECL for public banks in 2020 and COVID caused a whipsaw in provisions, but much of that impact has been reversed
- In 2023, the “rest” of the industry adopted CECL, with little impact on the level of industry reserves, and surprisingly little damage to earnings

# Credit Risk current comments from analysts and regulators...

- Credit Risk, FDIC 12/31/23 Quarterly Profile

	<u>Q4 2023</u>	<u>Q3 2023</u>	<u>Q4 2022</u>	<u>Pre Pandemic Average</u>
<b>Noncurrent loans</b>	0.86%	0.82%	0.73%	1.28%
<b>30-89 Days Past Due</b>	0.54%	0.61%	0.56%	0.66%
<b>Net Charge-off Rate</b>	0.65%	0.51%	0.36%	0.48%

- Credit Risk Update as of May 2024 (Janney)
  - In General, Bank's nonperforming loans and past due loans pale in comparison with criticized loans, especially in Commercial Real Estate (CRE) areas such as Office, Multifamily, Retail, Hotels, Industrial, and other collateral due to the change in debt service coverage ratios (DSCR) under stressed interest rates resulting in weaker DSCRs.

# What we are hearing from our client base...

- CRE – most community banks are concerned about the economy in general, but most do not have much exposure to the “large, urban office space” risk that we see in major cities and the larger banks; some concerns about valuation due to uncertainty of cap rates and construction costs
- Construction loans - some concerns about the quality of cost estimates given uncertainty of construction costs;
- Commercial – concerns appear to be in certain industries, as well as a general concern about political uncertainty and economic conditions
- Loan pricing is getting a lot of attention, due to significant increases in cost of funds; pricing is an issue in underwriting as well, as lenders consider whether borrowers can absorb the higher loan payments as a result of the higher loan rates
- So far, little specific regulatory criticism about CECL implementation as a process

# Quick overview of CECL implementation....

- Overall, the impact of loan reserve levels was surprisingly low
- Most community banks did not have a significant implementation adjustment to equity
- Still a lot of questions about the reserve for unfunded commitments
- Some concerns over what will happen when economic conditions worsen, and the industry begins to experience charge offs

# Next steps for CECL...

- If you haven't yet...you'll need to have a model validation
- Should be discussing how best to track actual funding of loan commitments, and establish a process for evaluating the assumptions and level of reserves on unfunded
- The market seems to be presuming significant changes in economic conditions. You should be thinking about how to react to changes, with respect to adjustments to qualitative factors and the forecasting component of the CECL model.

# CECL WARM Method Peer Data

CECL Peer Data



	WARMs				Trendline	Q-Factors				Trendline	ACL (collectively assessed) / Loans				Trendline
	2Q23	3Q23	4Q23	1Q24		2Q23	3Q23	4Q23	1Q24		2Q23	3Q23	4Q23	1Q24	
1-4 Family Resi Mortgage: 1st Lien	6.65	6.63	6.85	6.36		0.65	0.59	0.63	0.63		0.96	0.89	0.94	0.89	
1-4 Family Resi Mortgage: Jr. Lien	3.56	3.65	3.69	3.87		0.50	0.45	0.55	0.61		0.64	0.55	0.60	0.65	
1-4 Family: Revolving	2.65	2.82	2.54	3.08		0.50	0.45	0.50	0.57		0.62	0.54	0.60	0.64	
<b>Total 1-4 Family Residential</b>	<b>6.37</b>	<b>6.33</b>	<b>6.34</b>	<b>5.96</b>		<b>0.62</b>	<b>0.57</b>	<b>0.61</b>	<b>0.62</b>		<b>0.93</b>	<b>0.87</b>	<b>0.91</b>	<b>0.90</b>	
<b>Multifamily Residential Loans</b>	<b>4.05</b>	<b>4.05</b>	<b>3.81</b>	<b>4.22</b>		<b>0.54</b>	<b>0.50</b>	<b>0.55</b>	<b>0.61</b>		<b>0.65</b>	<b>0.55</b>	<b>0.60</b>	<b>0.60</b>	
1-4 Family Resi Construction	1.00	0.99	1.00	0.96		0.60	0.60	0.61	0.65		0.65	0.61	0.63	0.67	
Other Construction, Dev. & Land	2.75	2.62	2.51	2.74		0.65	0.62	0.65	0.71		0.70	0.67	0.71	0.75	
<b>Total Construction &amp; Land Dev.</b>	<b>2.07</b>	<b>2.00</b>	<b>2.00</b>	<b>2.19</b>		<b>0.65</b>	<b>0.65</b>	<b>0.66</b>	<b>0.72</b>		<b>0.69</b>	<b>0.66</b>	<b>0.72</b>	<b>0.76</b>	
Owner Occ. Nonfarm Nonresidential	5.01	4.94	4.71	4.84		0.71	0.75	0.80	0.75		0.93	0.92	0.95	0.92	
Other Nonfarm Nonresidential	4.61	4.50	4.33	4.30		0.77	0.75	0.78	0.80		0.90	0.89	0.90	0.90	
<b>Total Nonfarm Nonresidential</b>	<b>4.96</b>	<b>4.77</b>	<b>4.70</b>	<b>4.70</b>		<b>0.75</b>	<b>0.71</b>	<b>0.76</b>	<b>0.76</b>		<b>1.00</b>	<b>0.92</b>	<b>0.97</b>	<b>0.95</b>	
Loans Secured by Farmland	3.59	3.91	3.89	4.31		0.45	0.45	0.52	0.60		0.60	0.56	0.62	0.61	
<b>Total Real Estate Loans</b>	<b>5.45</b>	<b>5.28</b>	<b>5.39</b>	<b>5.14</b>		<b>0.70</b>	<b>0.70</b>	<b>0.70</b>	<b>0.73</b>		<b>0.99</b>	<b>0.92</b>	<b>0.92</b>	<b>0.95</b>	
<b>Commercial &amp; Industrial</b>	<b>2.66</b>	<b>2.72</b>	<b>2.60</b>	<b>2.66</b>		<b>0.80</b>	<b>0.80</b>	<b>0.81</b>	<b>0.86</b>		<b>1.06</b>	<b>1.13</b>	<b>1.09</b>	<b>1.05</b>	
Credit Card Loans	2.00	2.00	2.00	1.98		0.00	0.00	0.00	0.61		1.47	1.75	1.76	2.90	
Auto	2.37	2.32	2.30	2.49		0.55	0.50	0.55	0.65		0.89	0.82	0.86	0.94	
Other Consumer Loans	2.35	2.36	2.33	2.44		0.60	0.50	0.55	0.64		1.04	1.17	1.06	1.25	
<b>Total Consumer Loans</b>	<b>2.44</b>	<b>2.43</b>	<b>2.32</b>	<b>2.45</b>		<b>0.60</b>	<b>0.54</b>	<b>0.54</b>	<b>0.65</b>		<b>1.12</b>	<b>1.14</b>	<b>1.06</b>	<b>1.17</b>	
All Other Types of Loans	2.00	2.00	2.00	2.00		0.50	0.37	0.48	0.50		0.75	0.77	0.71	0.74	
Leases	2.00	2.00	2.00	2.00		0.00	0.00	0.00	0.32		0.05	0.23	0.28	0.31	
<b>Total Gross Loans</b>	<b>4.65</b>	<b>4.65</b>	<b>4.68</b>	<b>4.52</b>		<b>0.75</b>	<b>0.73</b>	<b>0.73</b>	<b>0.75</b>		<b>1.08</b>	<b>1.01</b>	<b>1.01</b>	<b>1.03</b>	

\* **GREEN** text indicates a quarterly increase, **RED** indicates a decrease

Note: All data is proprietary from CECLSolver™ scenarios. These are medians of the total scenarios run by our client base (some clients may run multiple scenarios). This dataset is designed to provide context for users to understand how peers are treating these topics - they should not be relied upon to determine any specific bank assumptions. Do not share or distribute. Copyright QwickRate LLC 2024.

# CONTACT



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# FAST FACTS

## Saltmarsh, Cleaveland & Gund

At Saltmarsh, we believe the way to achieve success is by contributing to the success of others, which is why we thrive in **genuine relationships**. Our passion for people and **excellence** is more than a shared value; it's the foundation of our work.

### SIZE OF FIRM



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5

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Destin  
Orlando  
Pensacola  
Tampa

TENNESSEE  
Nashville

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SALTMARSH FINANCIAL ADVISORS, LLC



THE BDO ALLIANCE USA



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