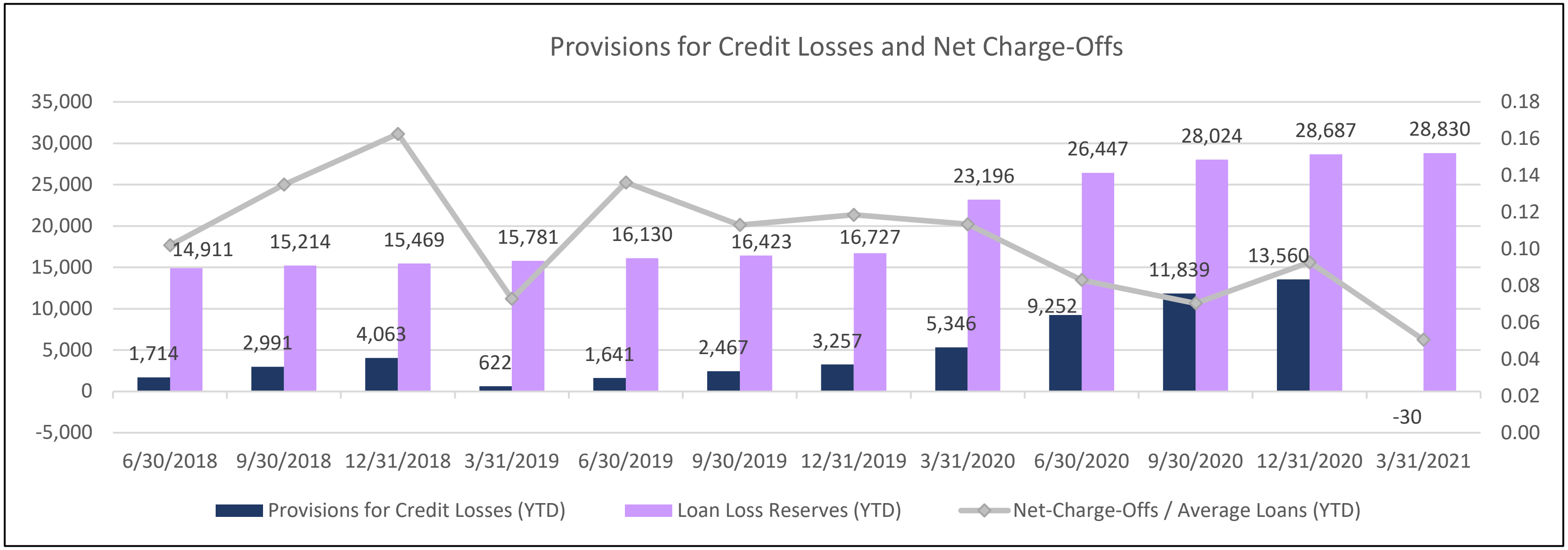
Commercial Loan Portfolio Quality Trends
1Q21

CEIS REVIEW INC.
Commercial Portfolio Advisors EST 1989

The following is a summary of a limited topics that CEIS quarterly surveys. The CEIS database includes various other indicators such as grade variances, grade outlooks, covenant compliance, new and renewed characteristics, and other related statistics.

CEIS enjoys a business relationship with approximately 130 commercial lenders of which 65-70% are Community Banks. The remaining are larger banks, foreign branch offices, and other commercial lenders.

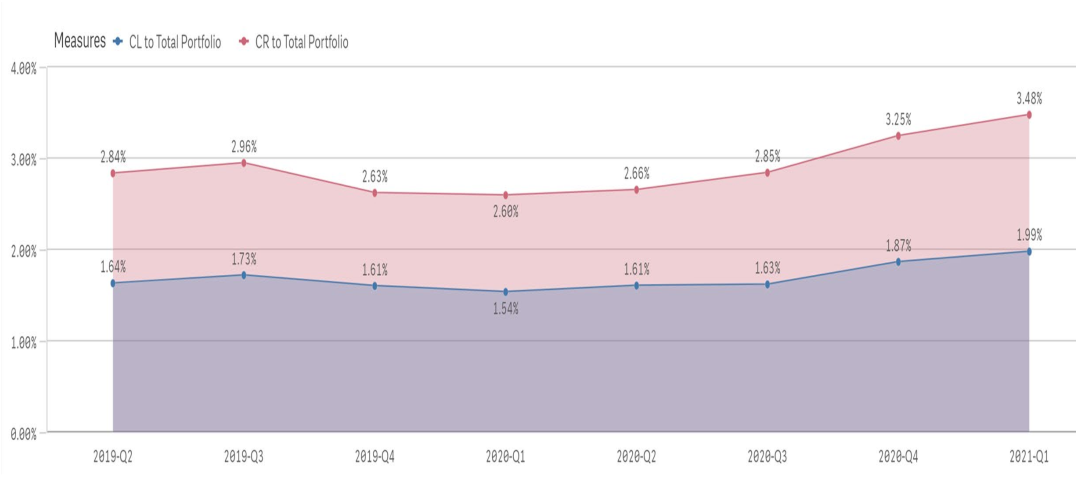
Provisions for Credit Losses, Reserves and Net Charge-Offs



Source: UBPR Data for All CEIS Clients

Loan Quality

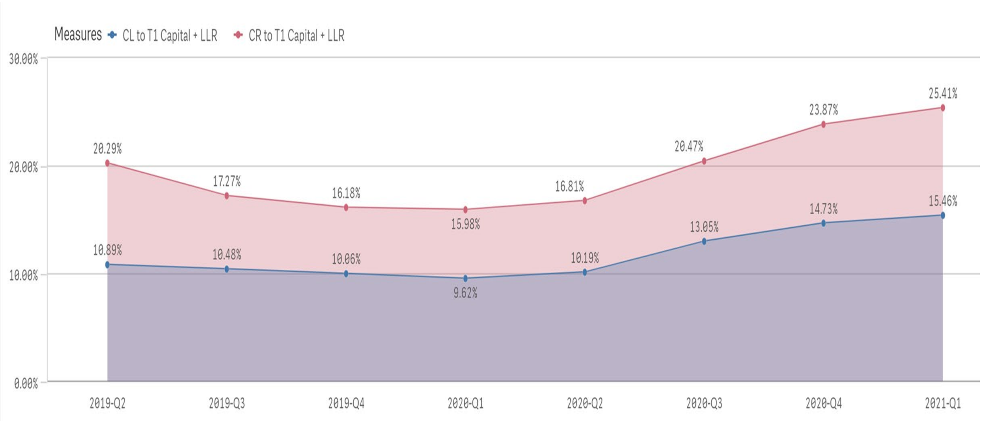
Criticized & Classified ("CrCl")/ Total Portfolio



Given the indicated profile of the subject portfolios, for 1Q2021 the ratios of criticized (Special Mention, Substandard, Doubtful) and classified (Substandard, Doubtful) to total portfolio have trended upwards since 1Q2020 with the averages most recently at 3.48% and 1.99%, respectively. In comparison, the ratios at 1Q2020 were at 2.60% and 1.54%, respectively.

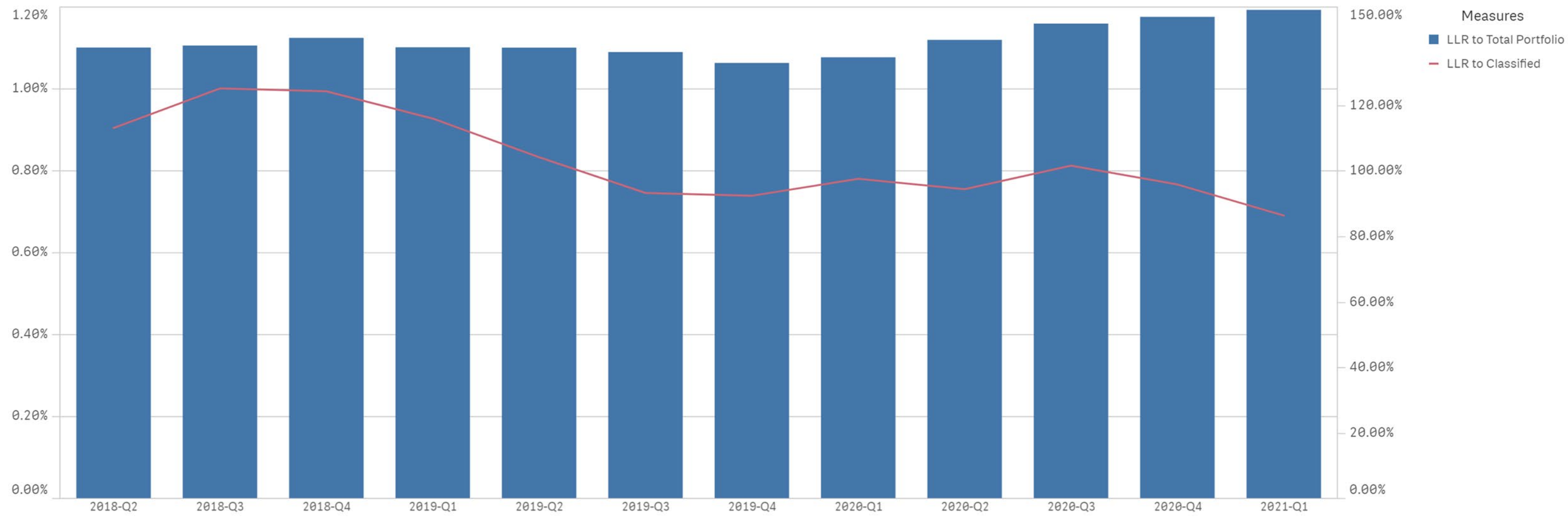
Criticized & Classified ("CrCl")/Capital + LLR

The similar ratios of criticized and classified to the sum of tier I capital plus loan loss reserves have trended upward since the 1Q2020 to the current 25.72% and 15.5%, respectively. As comparison, the ratios at 1Q2020 were at 15.98% and 8.62%, respectively. Non-performing over the three quarters ended March 31, 2021, rose to 8.45% of capital plus reserves from what was range of 4.01 % and 4.51% for the five quarters ended June 30, 2020.

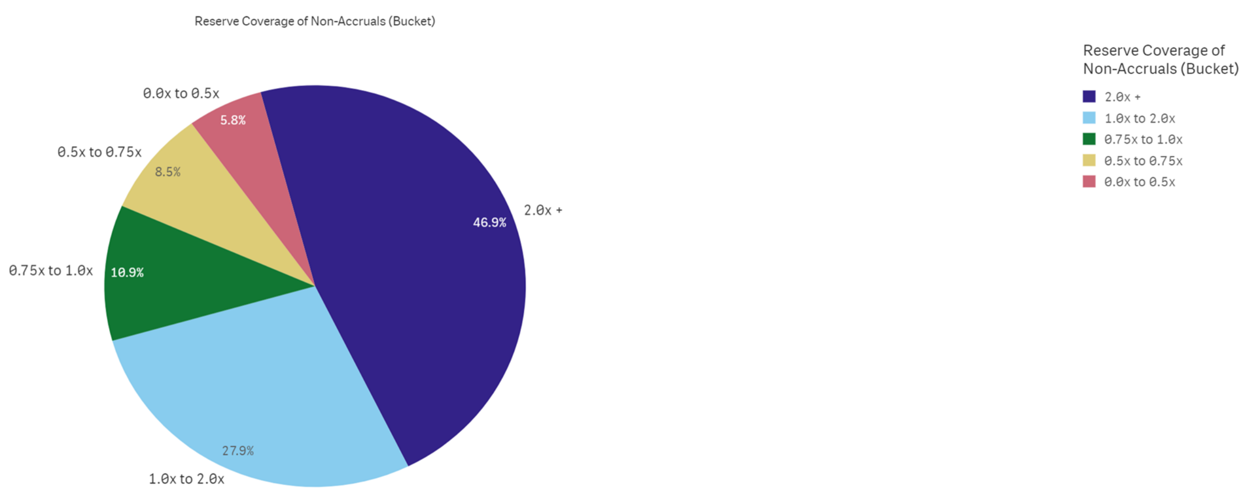


Source: CEIS Data for All Banks

Reserve Coverage

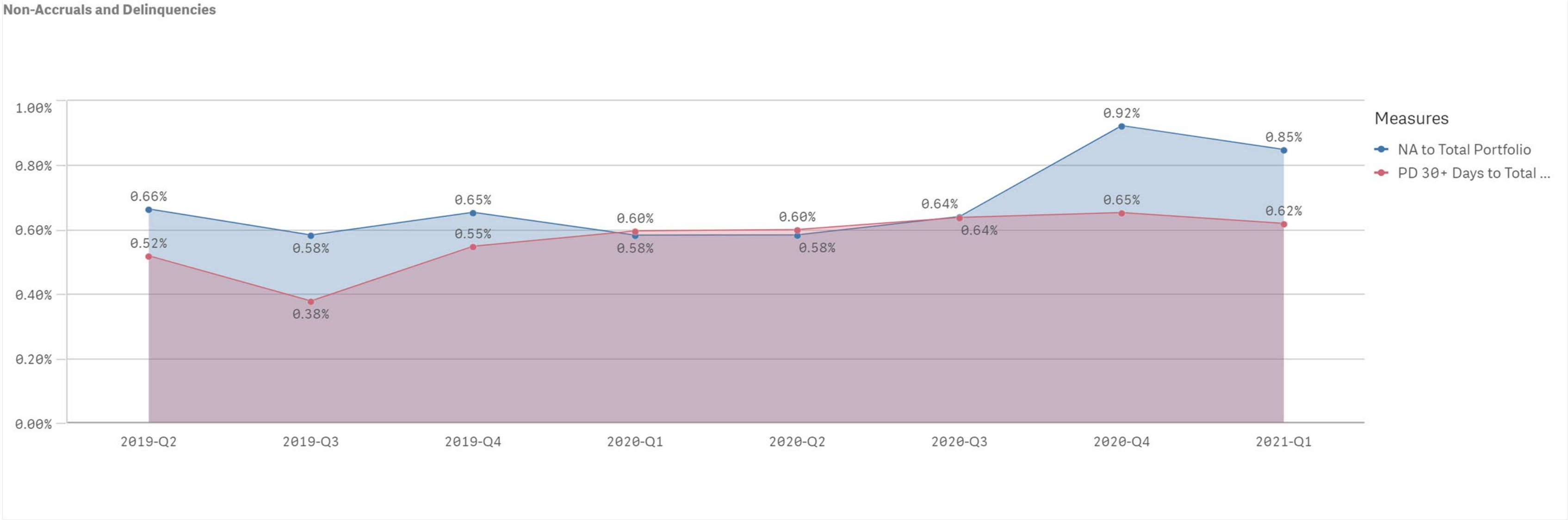


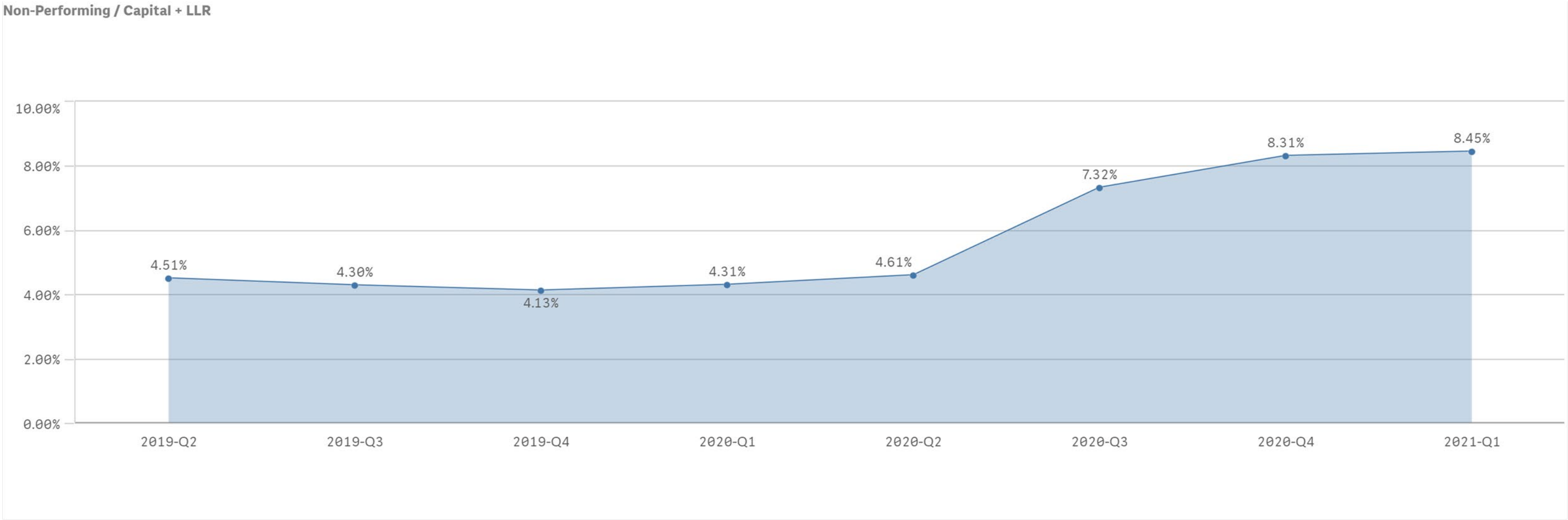
Reserve Coverage of Non-Accruals



Source: CEIS Data for All Banks

Non-Performing Loans



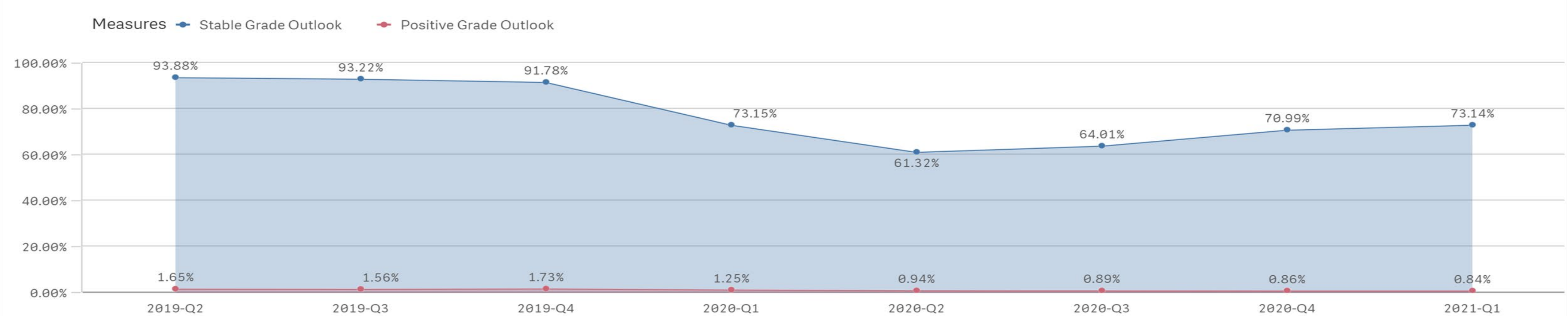


Source: CEIS Data for All Banks

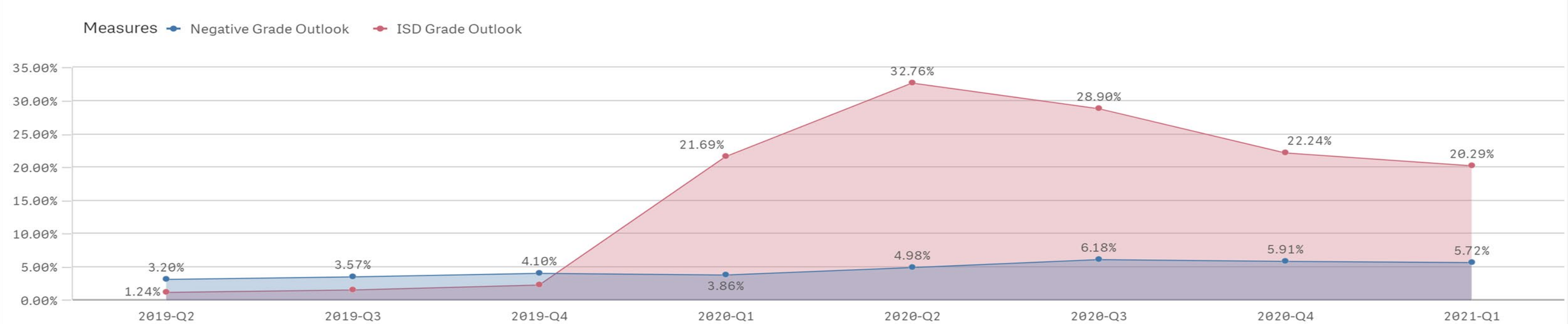
Grade Outlook – All Loans

The following are CEIS' estimates of the six-month outlook for assigned grades. The graphs show that since 4QE19, the level of uncertainty regarding the COVID impact on portfolios is clearly evident.

Combined Grade Outlook - Positive and Stable



Combined Grade Outlook - Negative and ISD

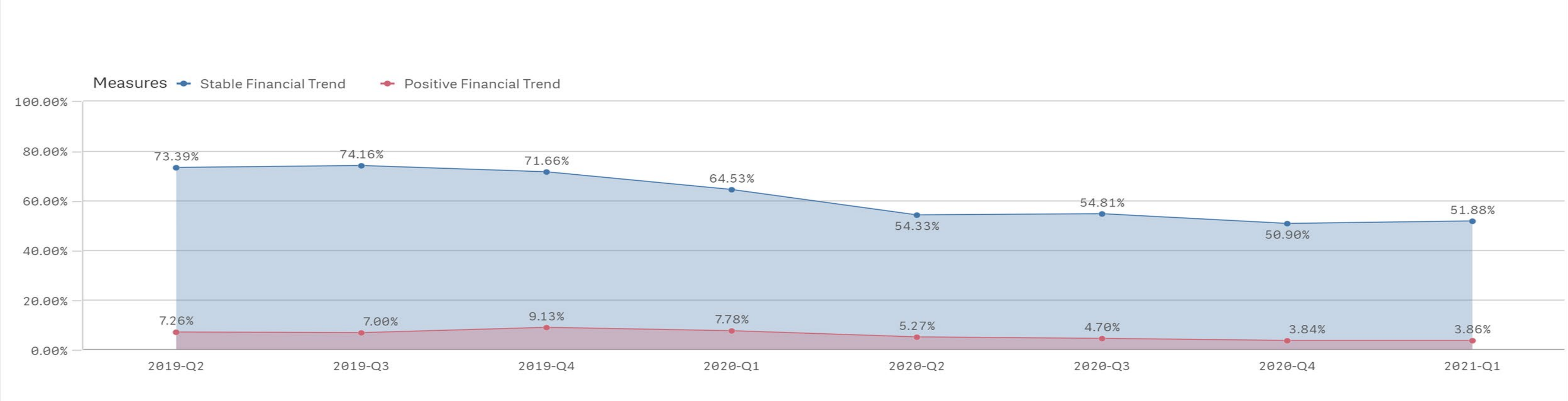


Source: CEIS Data for All Banks

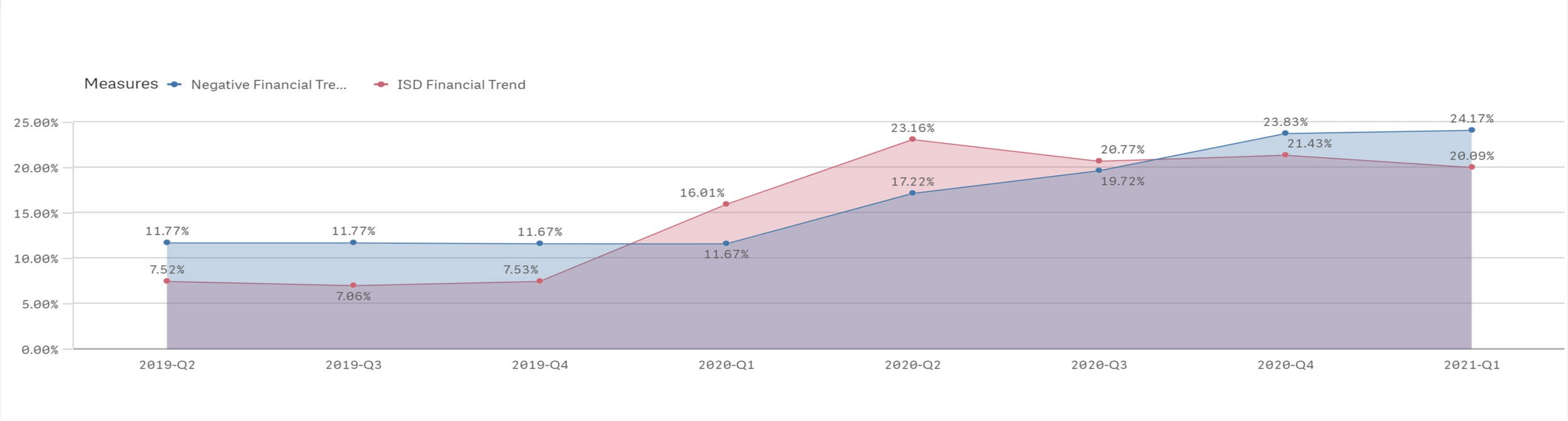
Financial Trend – All Loans

The following are the observations made regarding the financial trend of the borrowers. The graphs show that since 4QE19, the level of uncertainty regarding the COVID impact on borrowers is clearly evident.

Combined FT - Positive and Stable



Combined FT - Negative and ISD

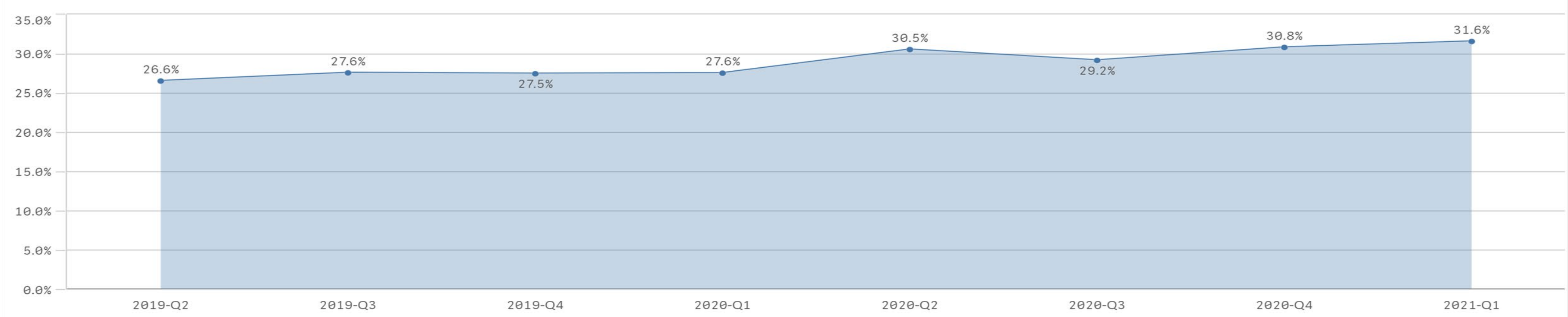


Source: CEIS Data for All Banks

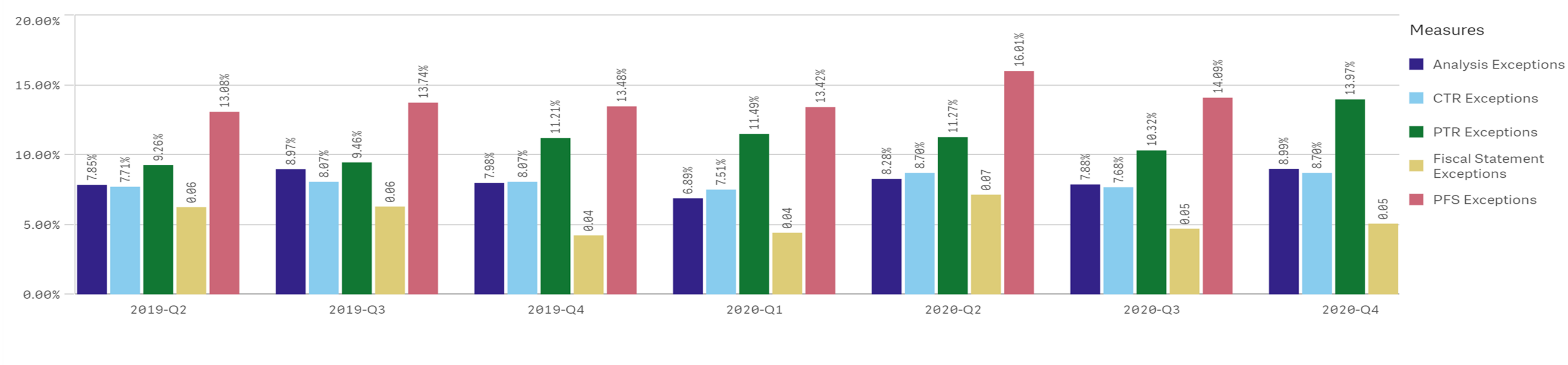
Technical Exceptions

The following represents the pattern on technical exception levels. The data shows a rise in the exception levels caused in part by the COVID environment impacting administrative priorities.

Borrowers with Exceptions



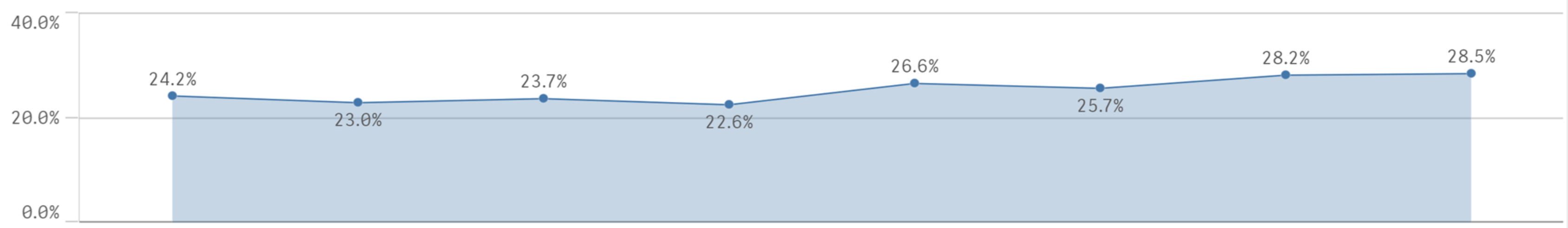
Exceptions by Type



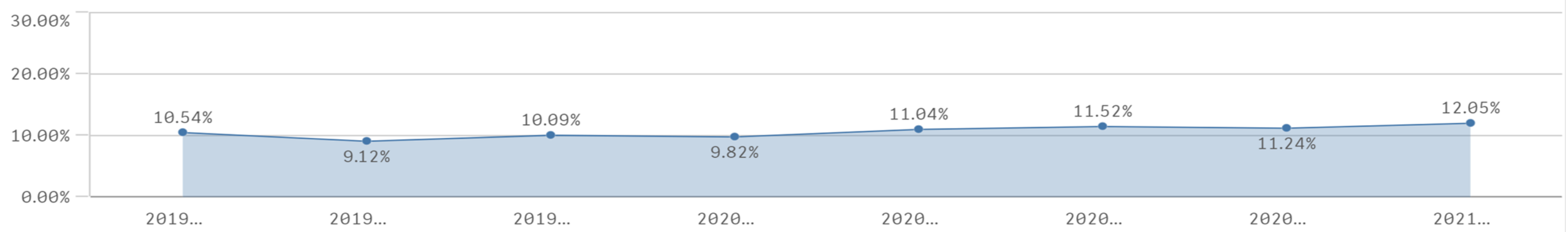
Source: CEIS Data for All Banks

Covenant Compliance

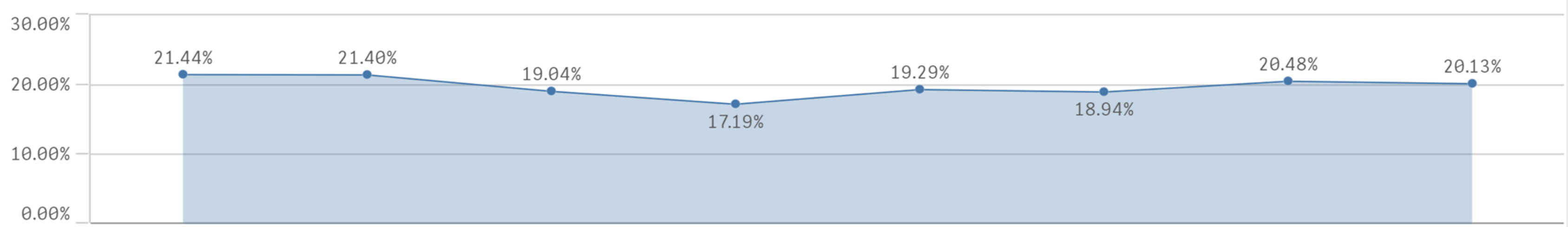
Non-Compliant Covenants



Covenants Waived or Amended



Covenants Not Tracked



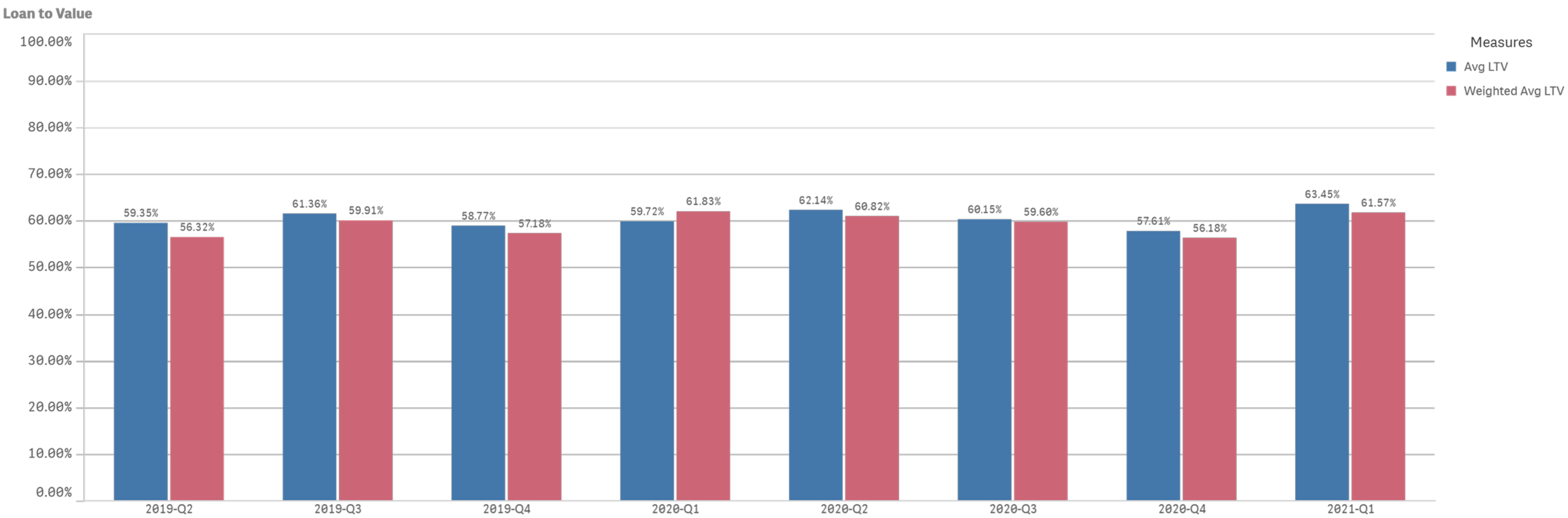
Source: CEIS Data for All Banks

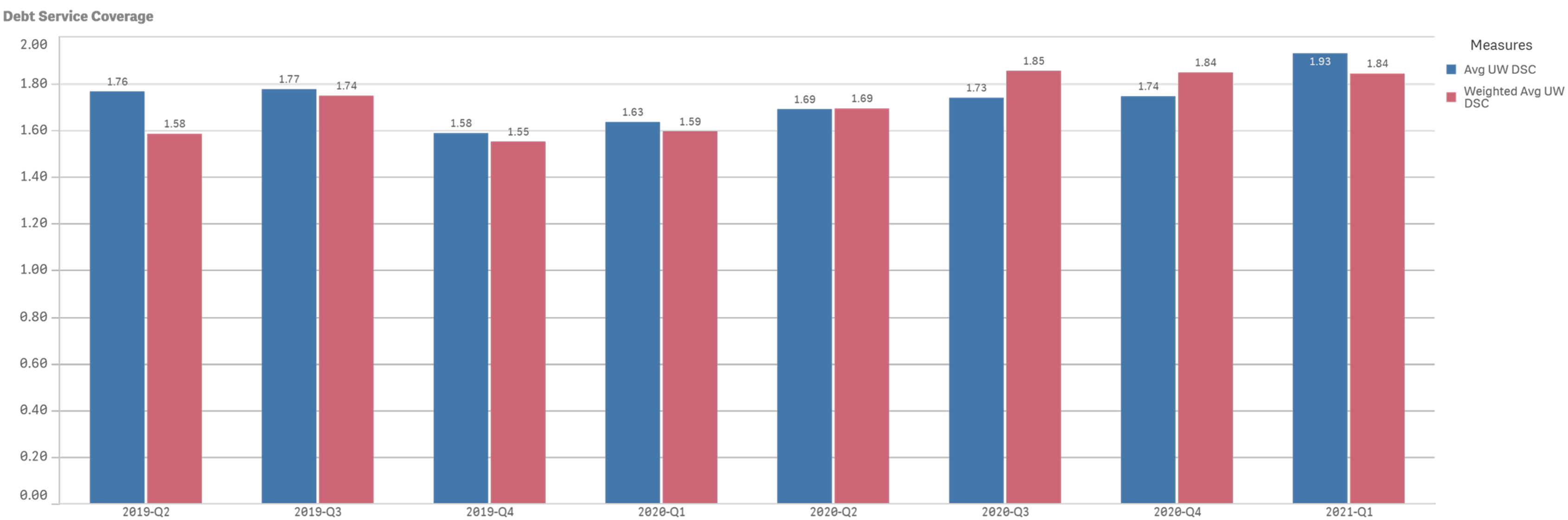
New and Renewed*

(Following Pages)

* CEIS Data for all loans originated or renewed in the trailing 12-month period for each quarter

Loan to Value and Debt Service Coverage - CRE

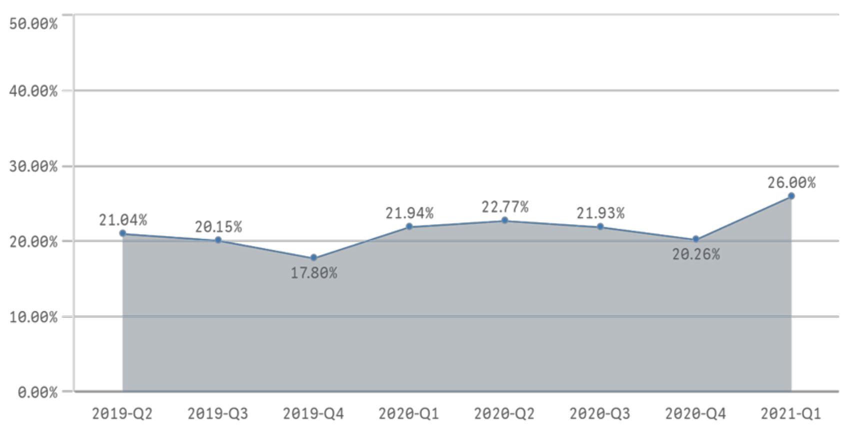




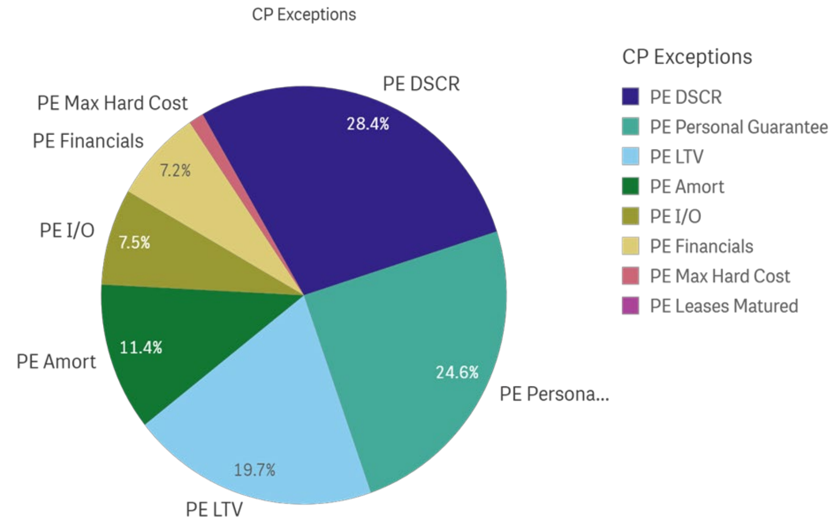
Source: CEIS Data for All Banks

Credit Policy Exceptions

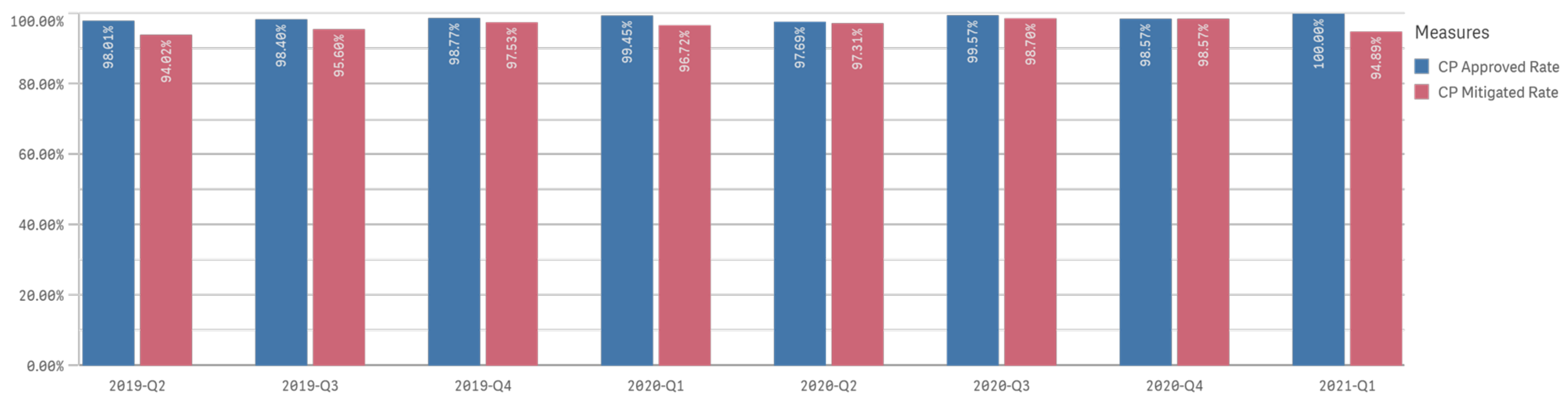
Loans with Credit Policy Exceptions



CP Exceptions by Type

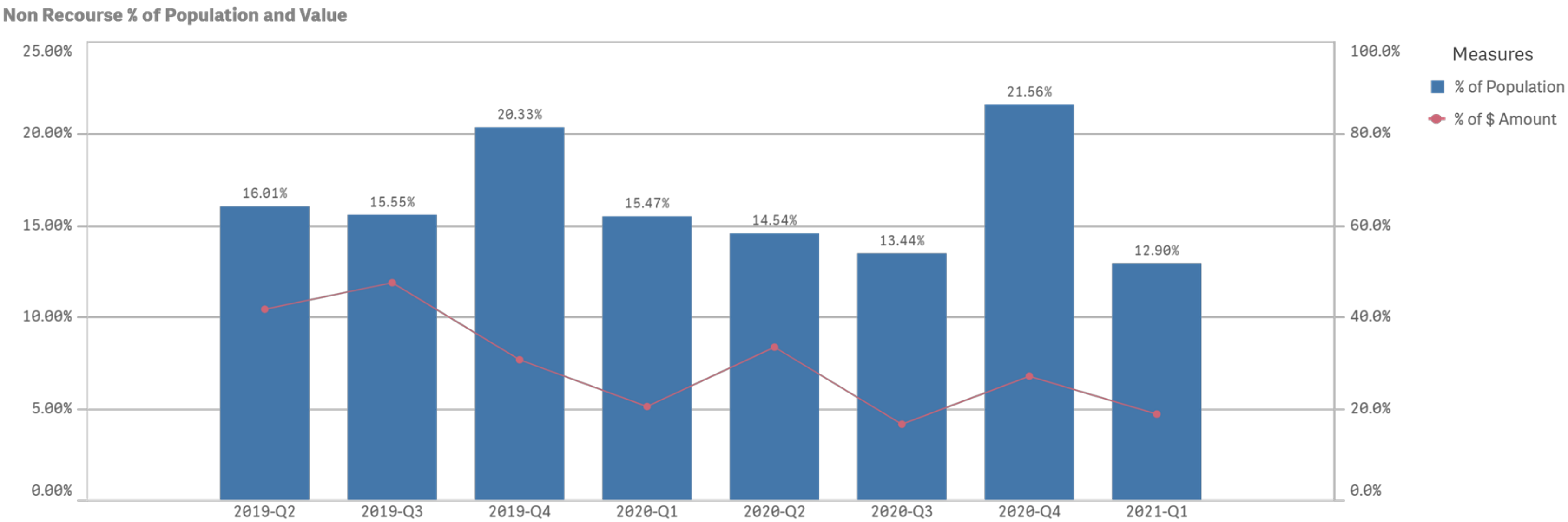


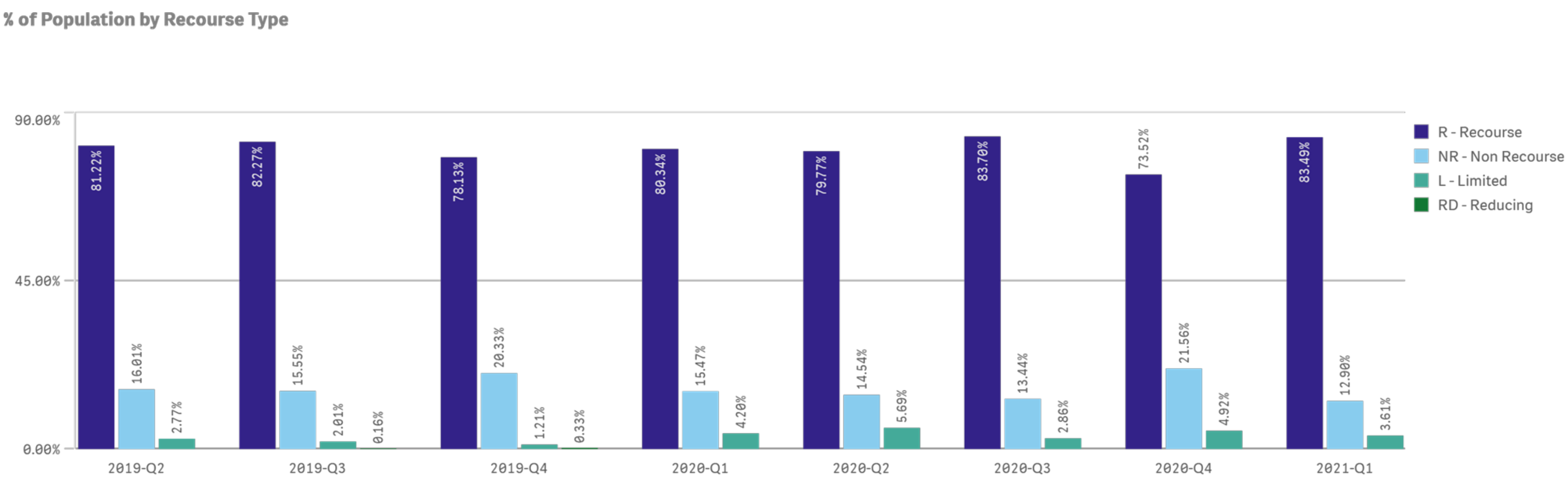
CP Exceptions Approved and Mitigated



Source: CEIS Data for All Banks

Non-Recourse

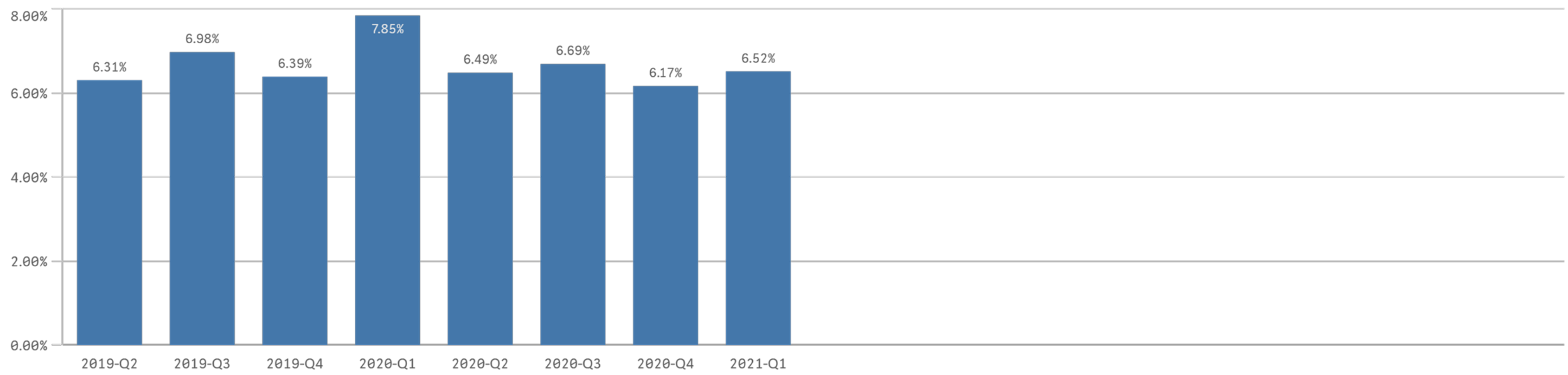




Source: CEIS Data for All Banks

Cap Rates – CRE

Average Cap Rates



Average Cap Rates by Property Type

propertyType	2019-Q2	2019-Q3	2019-Q4	2020-Q1	2020-Q2	2020-Q3	2020-Q4	2021-Q1
1 - Office building	6.48%	6.70%	6.72%	6.87%	6.71%	7.87%	5.87%	6.79%
2 - Shopping Center	7.29%	7.15%	7.00%	7.12%	7.10%	7.60%	7.54%	7.88%
3 - Multifamily	5.57%	6.11%	5.71%	5.52%	5.29%	5.55%	5.36%	5.43%
4 - Single Family	5.54%	14.80%	4.56%	5.70%	12.83%	4.88%	5.94%	5.38%
5 - Industrial building	6.53%	7.23%	6.15%	6.59%	6.84%	6.48%	5.76%	6.10%
6 - Retail building	6.37%	7.09%	6.49%	13.93%	6.14%	6.82%	6.19%	6.67%
7 - Hotel, Motel	8.38%	7.81%	8.57%	8.03%	7.80%	7.90%	7.48%	8.83%
8 - Mixed use	5.92%	6.00%	5.57%	5.98%	5.60%	6.01%	5.79%	5.90%
9 - Church, Synagogue, etc.	-	7.00%	6.63%	8.00%	-	-	-	9.50%
10 - Vacant land	5.11%	10.25%	5.75%	6.00%	5.25%	4.12%	4.75%	10.83%
11 - Other	7.56%	7.81%	9.22%	9.32%	9.78%	8.22%	9.08%	7.58%

Source: CEIS Data for All Banks

More Notable Bank Examiner Concerns

- Given the economic impact of the coronavirus still masked by numerous relief efforts in 2020 and proposed for 2021, community banks should act conservatively in 2021. Ensuring they have proper risk management processes in place. Understand the risk in your portfolio.
- A greater focus on industry and group concentrations in loan portfolios. It is recommended that Banks review current concentration limits, adjust as appropriate and closely monitor, especially in higher risk industries such as real estate, retail, hospitality & leisure and travel.
- More emphasis placed around timely and ongoing loan reviews with expectations that Banks increase the frequency of individual loan reviews based on severity of risk. Quarterly or monthly reviews for higher risk transactions may be appropriate.
- Closer tracking of adherence to credit policy. Banks are cautioned to keep policy exceptions to a minimum and properly document all mitigating factors in detail. Banks are recommended to take a thorough look at their policies including determination of appropriate underwriting risk parameters and metrics.

More Notable Bank Examiner Concerns

- Risk Ratings – It is important to understand the key risks of each individual borrower, considering financial performance pre-COVID-19, the impact of COVID-19 both short term and long term, relief/stimulus provided during the pandemic, repayment ability, collateral, and industry considerations. Banks should be in close contact with their largest borrowers and those with higher risk loans.
- Banks need to exercise good judgement with borrowers going forward as they come off the loan deferrals or may need additional time. Regulators will continue to look at all aspects of risk and relevant information on borrowers including the willingness and ability of sponsors to support the underlying borrowers, with focus on sufficient liquidity or alternative cash flow to cover shortfalls.
- Stress testing is suggested on both a loan and portfolio basis. Additionally, Banks are recommended to perform a pandemic stress test analysis that segregates the loan portfolio by NAICS code so Banks can see which industries are potential problem segments.
- Expected increase in M&A activity in 2021 as stronger banks take advantage of opportunities with weaker performing institutions as well as the potential for more IT and Fintech related partnerships.
- While the CECL deadline for Community Banks is not for a few years, Banks are recommended to prepare sooner rather than later.
- It is recommended that Banks speak with their regulators before issuing dividends or buying back stock.

CEIS REVIEW INC.

CEIS is an independent consulting firm established in 1989, serving the needs of organizations with general and/or specialized commercial loan portfolios.

Loan Review, ALLL / LLR Methodology and Validation, Portfolio Stress Testing, Portfolio Acquisition Review, Leveraged Lending Review, Municipal and Public Finance Review, Loan Policy Maintenance, Process Review, and Customized Loan and Credit Seminars.

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