4Q25 Commercial Credit Observations (CCO) Report

Q4 2025 | Key Actionable Insights for Senior Banking Executives	
35%	of borrowers with active covenants were non-compliant in Q4 2025
23%	of new and renewed loan decisions included a credit policy exception
6.35%	of dollars reviewed carried a risk rating variance between the bank and CEIS

These metrics are not reported in call reports or regulatory filings; they are accessible exclusively through comprehensive independent loan reviews.

About This Report

The CEIS Review Commercial Credit Observations (CCO) Report is published quarterly and reflects aggregated findings from active loan review engagements conducted across more than 100 community banks nationwide. Unlike peer analyses derived from call reports or regulatory filings, this report draws on loan-level data accessible only through independent credit review — including covenant compliance rates, credit policy exceptions, risk rating variances, and origination underwriting quality metrics. The Q4 2025 edition reflects portfolio conditions as of December 31, 2025.

Executive Summary

During Q4 2025, CEIS client community banks observed a continued decline in credit quality, reflected by incremental deterioration in commercial real estate (CRE) metrics. This trend has predominantly resulted from higher loan rates and reduced property values due to increased vacancies and higher capitalization rates, as indicated by recent appraisals. Consequently, CEIS noted a greater number of risk rating variances across client portfolios and ongoing

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covenant pressures. Provisioning and reserves have been adjusted to reflect these developments; however, criticized credits are now categorized at higher levels of risk, while underwriting exceptions for new loans are above historical norms.

Portfolio Quality: What We're Seeing

Criticized & Classified Migration

Criticized-to-portfolio continued its upward drift, reaching **4.89%** (median 3.58%) by Q4 2025. Classified-to-portfolio moved to **2.71%** (median 1.66%). The proportion of banks with ≥4% criticized exposure rose to 42.1%, and those with ≥4% classified exposure increased to 22.4%, both deteriorating versus Q3. Relative to Tier 1 Capital + LLR, Criticized increased to 29.7% and Classified to 16.8%, with more institutions now in the 25–35% and ≥50% bands than earlier in the year.

Nonperforming & Delinquencies

Non-accruals/portfolio eased modestly to **1.29%**. Non-performing/Tier 1 + LLR declined from its peak to **8.74%**, but the level still implies thinner capital coverage if deterioration accelerates. Commercial delinquencies continue to show mixed signals: CRE delinquencies ticked up in Q4, while C&I delinquencies showed near-term improvement.

Reserves & Coverage

LLR/portfolio moved up to **1.21%**, broadly tracking risk migration. Reserve coverage of classified dipped to approximately **84%**, indicating the need to reassess qualitative CECL overlays where grade migration persists.

Risk Rating Variances

Grade variances (Bank vs. CEIS) rose to **6.35% of dollars reviewed** and **7.51% of loans**, with a notable share of pass-to-criticized/classified re-ratings in CEIS samples — an early signal that internal ratings may be lagging current conditions.

Covenants & Exceptions

Roughly **35%** of borrowers with active covenants were non-compliant in Q4 (up from 34–35% in Q3), while waivers/amendments increased to **12%** of covenanted credits. Not-tracked covenants remain at 21–22%. Technical exception rates are steady but elevated at 18–21%.

Concentration & Mix

CRE concentrations continued to rise: CRE/portfolio averaged **60%** (all banks) in Q4; NOO CRE remains the largest segment, relatively flat since 3Q22. Construction and multifamily exposures are creeping up in both average and median terms.

New & Renewed Originations (Trailing 12 Months to Q4 2025)

Underwriting Posture

Credit policy exceptions for new/renewed loans climbed to **23% of decisions** (from 22–23% in Q3), and while most were “approved/mitigated,” the cumulative exception rate warrants tighter pre-clearance and post-closing controls.

CRE Metrics

Average LTV has drifted higher to **60%** (weighted average 59%), and weighted average DSCR (UW) slipped to **1.09x**; property-type detail shows pressure most evident in NOO and selected multifamily buckets, particularly at smaller ticket sizes. Non-recourse share of new/renewed by dollars is 24%, adding structural risk under stressed refinancing scenarios.

Market Context

Reported cap rates are rising modestly across CRE types, and debt yield vs. DSC overlays indicate thinner cushions under higher-rate/flat-NOI conditions.

Recent Regulatory Releases

OCC & FDIC Rescind 2013 Leveraged Lending Guidance (Dec 5, 2025)

The OCC and FDIC jointly rescinded the 2013 Interagency Guidance on Leveraged Lending and 2014 FAQs, citing over-breadth, procedural concerns, and unintended migration of activity to nonbanks. Examiners will now assess leveraged lending under general safety-and-soundness principles, with banks determining their own internal definition of a “leverage loan.” The Federal Reserve did not join this rescission at the time of issuance.

CEIS Review Interpretation

The shift removes prescriptive constraints but raises the burden on banks to demonstrate prudent frameworks: clear risk appetite for leveraged exposures, robust sponsor/guarantor analysis, sustainable free-cash-flow based repayment, and pipeline/distribution controls. Expect examiner focus on risk ratings, stress testing, concentration limits, and allowance adequacy — tailored to activity scale and complexity.

Senior Executive Takeaways

- **Tighten rating discipline and early warning:** Reduce grade variances by refreshing borrower financials rapidly, recalibrating pass/criticized triggers, and strengthening secondary repayment analysis.
- **Re-baseline CRE underwriting:** Given higher cap rates and weaker DSCR on recent originations, reaffirm LTV/DSCR floors, scrutinize interest-only terms, and cap non-recourse share where debt-yield fails stress hurdles.
- **Covenant governance:** Drive non-compliance down via standardized covenants, automated tracking, and pre-defined remedial playbooks.

- **Provisioning discipline:** With classified/portfolio and criticized/Tier 1 + LLR rising, revisit CECL qualitative factors, scenario weights, and individual impairment assessments — especially for NOO CRE and multifamily concentrations.
- **Verification and assessment of guarantor repayment capacity:** Banks are expected to obtain and review current financials for guarantors. The analysis should evaluate the guarantor's global cash flow, liquidity, contingent liabilities, and overall ability to support the borrower, especially under stress scenarios.

CEIS Review Concluding Perspective (Q4 2025)

The direction of risk remains gradually negative, not acute, characterized by creeping criticized/classified levels, softening DSCR, and persistent covenant/exception slippage. Capital and reserves remain adequate, but dispersion across institutions is widening. A disciplined back-to-basics posture — ratings accuracy, covenant rigor, CRE refinancing stress testing, and principled workout management — will define the institutions best positioned to navigate 2026.

Is Your Institution Seeing Similar Trends?

CEIS Review provides independent commercial loan review, portfolio stress testing, and credit risk consulting to community banks of all sizes — nationwide. If the metrics in this report raise questions about how your institution compares, we welcome a confidential conversation.

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