Crowe

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# Evolution of Credit

## Recent Stories from a Loan Review Backpackers Journey

2024 Bankers Summit

# Presenter

**Giulio Camerini**

Credit & Loan Review Principal
Giulio.Camerini@crowe.com

Let’s Connect: Connect on Linkedin

# Agenda

**1**

Credit risk industry update – Econ & what we are seeing

**2**

Commercial real estate – Dive into product

**3**

C&I – Dive into product

**4**

Agriculture – Dive into product

**5**

Wrap it Up

# Current credit risks industry is facing

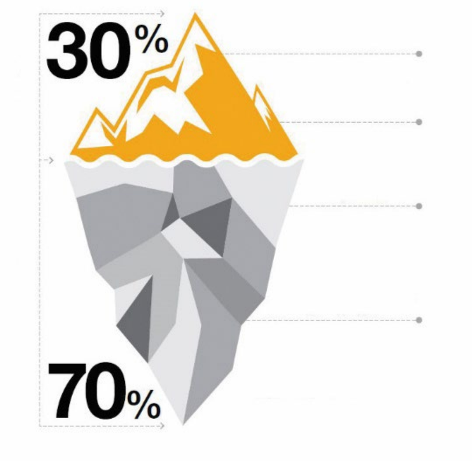
# These Are Very Fast-Moving Times for Risk

**Interest Rates**
- Renewals / Modifications still largest challenge
- Exit options remain tight
- Rebalancing / Restructures are happening

**Loan Review Activities**
- Risk rating migrations continue
- Foreclosures & hand backs have picked up & spreading
- Continue to have concern for 2017 – 2022 vintage

**Inflation**
- It is down but we are at a higher rate than 3 years ago still
- Will be bumpy road

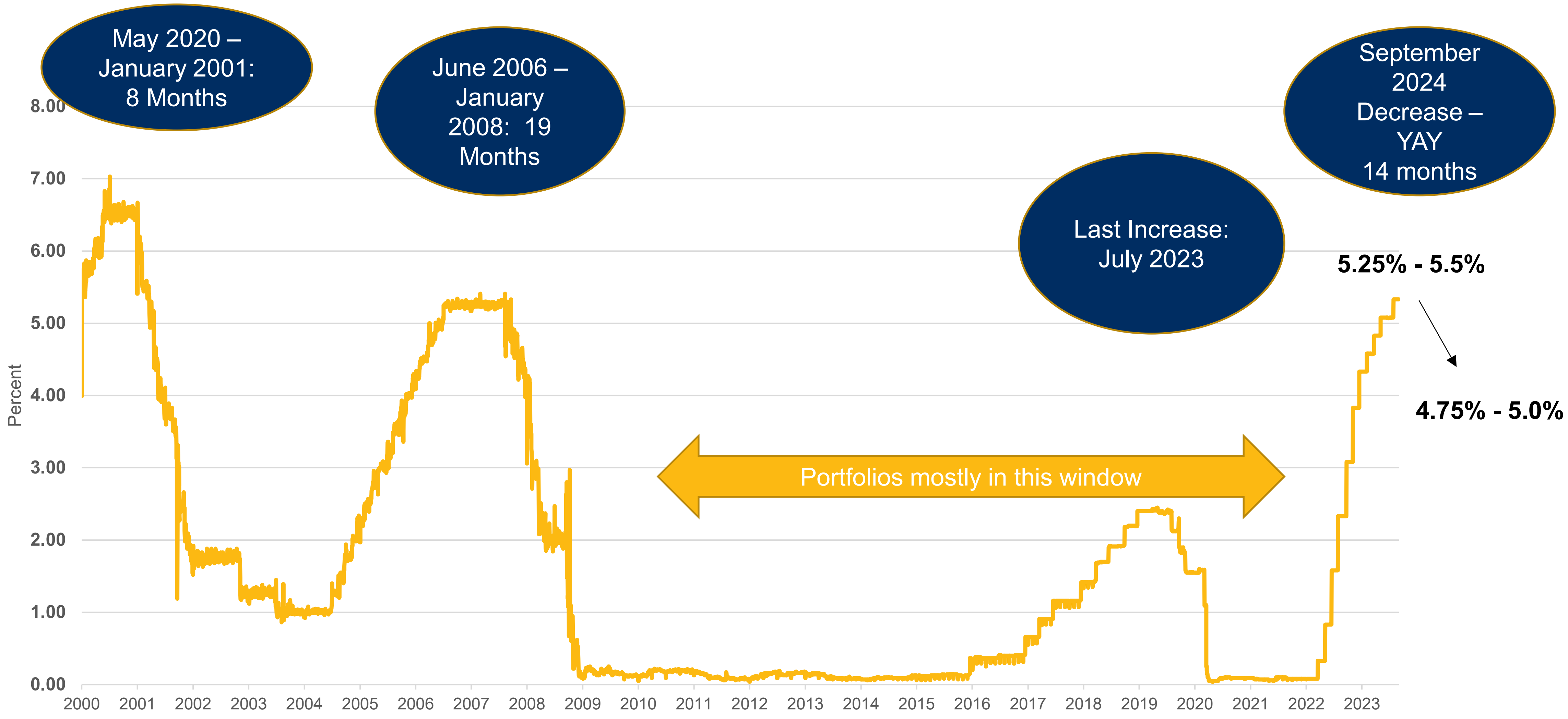
**Economy**
- There are areas that are fine and areas that are soft
- Continue to be cautious for items closely tied to general consumer




**Only what is at surface can be seen**

**2025 will be very dynamic**
- Even with rates lower, be ready for surface cracks and surprises to continue
- Have radars up now is great time to focus on credit administration & stay in tune to loan review observations

# Fed Funds Effective Rate




**Source: Board of Governors of the Federal Reserve System (US), fredstlouisfed.org)**

**Downgrades:**

*“I ain't as good as I once was, but I'm as good once, As I ever was”*

Toby Keith

# (Update) What Seeing In the Field

- **Increase in Risk Rating Changes**
  - Changes by management & LR are up
  - Weighted Avg risk ratings have increased
  - For LR changes any cases are those an annual review is behind + officer changes
  - Most agree with the changes – *speaks to how rapid*
  - Many are cases pushing for updated info and when looking at the info its softer
    - Rent rolls show softening trends + expenses up
    - C&I businesses freshest MTD & YTD softer

- **Dusting off problem loan monitoring**
  - Making many observations and best practice recommendations on problem loan reports
  - Doing a lot of training on risk rating (board, staff, all levels)
  - Many taking hard look at how scorecards behaving
  - Many are having to revisit how frequent evaluating collateral values (now that values declining most segments)

- **Comments from other clients recently**
  - Aside from office systemic issues not yet there but rather many surface cracks of one-off instances adding up.
  - Have seen some shuffling in loan officers due to retirements, departures, reassignments.
  - Many investing in technology – but that's long journey

- **<u>Multiple Cash Flow Scenarios is Way to Go</u>**
  - Actual with Addbacks / No Addbacks
  - Appraisal + Actual + Proforma (CRE)
  - Budget + FYE + YTD + QTD +MTD + Budget (C&I)

# What Hearing From Clients (Expanded):

- **Catch Up**
  - Trying to play catch up on Annual Reviews & Covenants
- **Improving Reporting Due to Rapidly Changing Environment**
  - Getting many asks to help look at concentration reporting
  - Upcoming maturity report
  - Averages reporting
  - Adding KRI's and dashboards

***Note: Much of this accelerated in the last quarter***

- **Recently Demand is Soft in Many Pockets**
  - Showing thru in many products – but hope remains with recent cuts.
- **Challenges With Talent**
  - Trained credit professionals have become harder and harder to find
  - Training programs have been cut and others have left the industry
  - Compression is a risk
  - Many resources have never been thru a downturn

***Note: Some of these challenges were present before Covid - amplified after Covid***

***Football is blocking and tackling everything else is mythology.***

*- Vince Lombardi*

# Recent articles

## How banks can plan for commercial property insurance costs

Giulio Camerini, Scott Muyskens
1/16/2024

**Banks can take steps now to address changing property insurance costs to mitigate portfolio and problem loan risks.**

- https://www.crowe.com/insights/how-banks-can-plan-for-commercial-property-insurance-costs

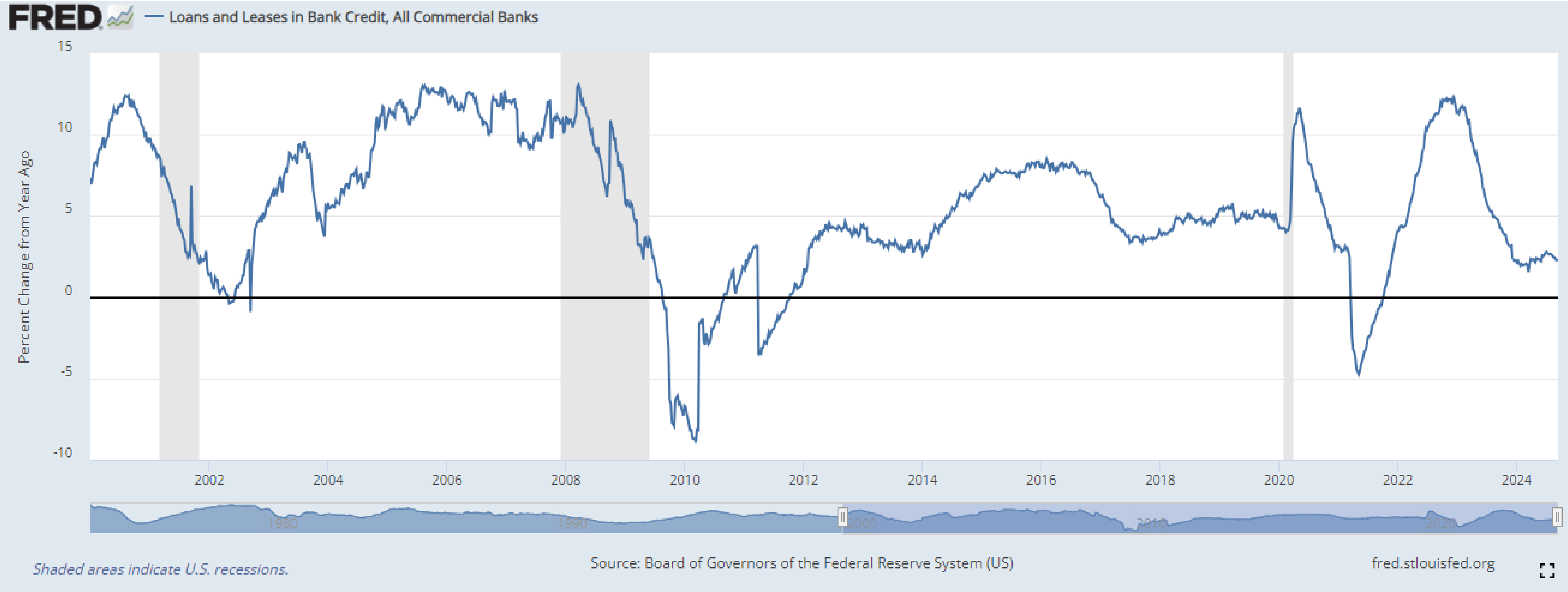
## Managing CRE concentration risk through change

Giulio Camerini, Ben Cayson
3/19/2024

**While the economic environment might change, needing a plan for managing commercial real estate concentration risk does not.**

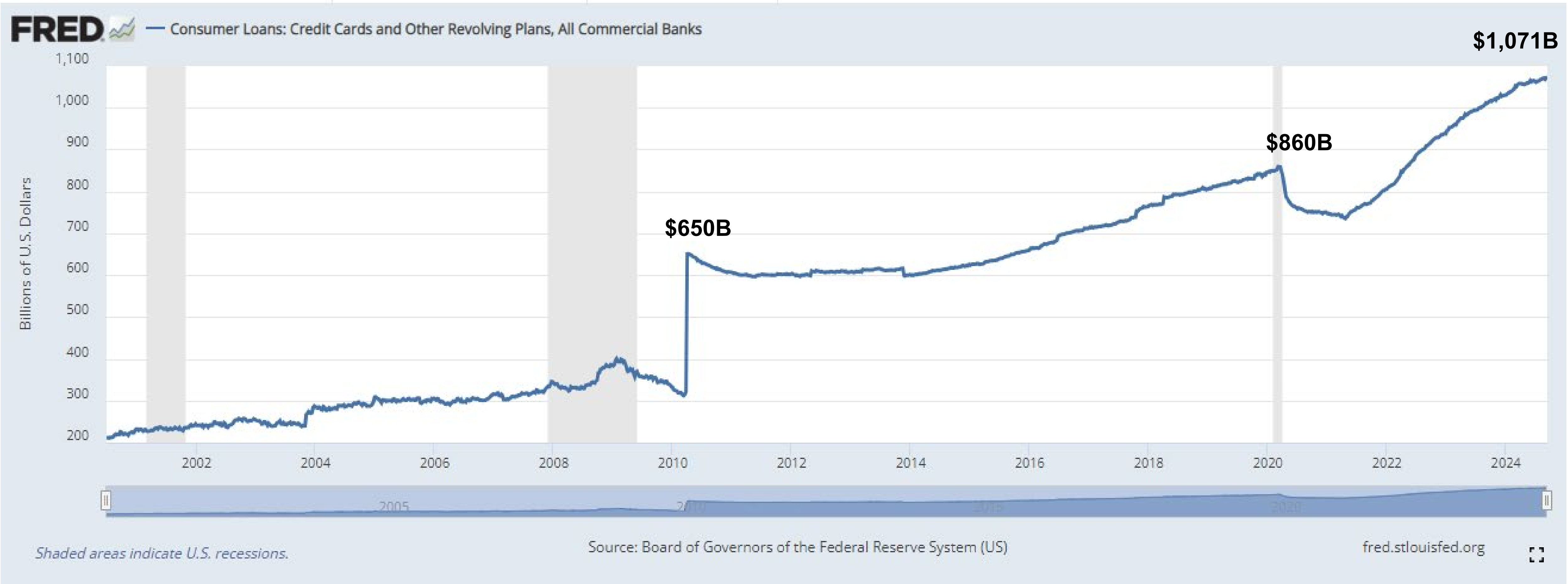
- https://www.crowe.com/insights/managing-cre-concentration-risk-through-change

# Loans & Leases YoY Growth



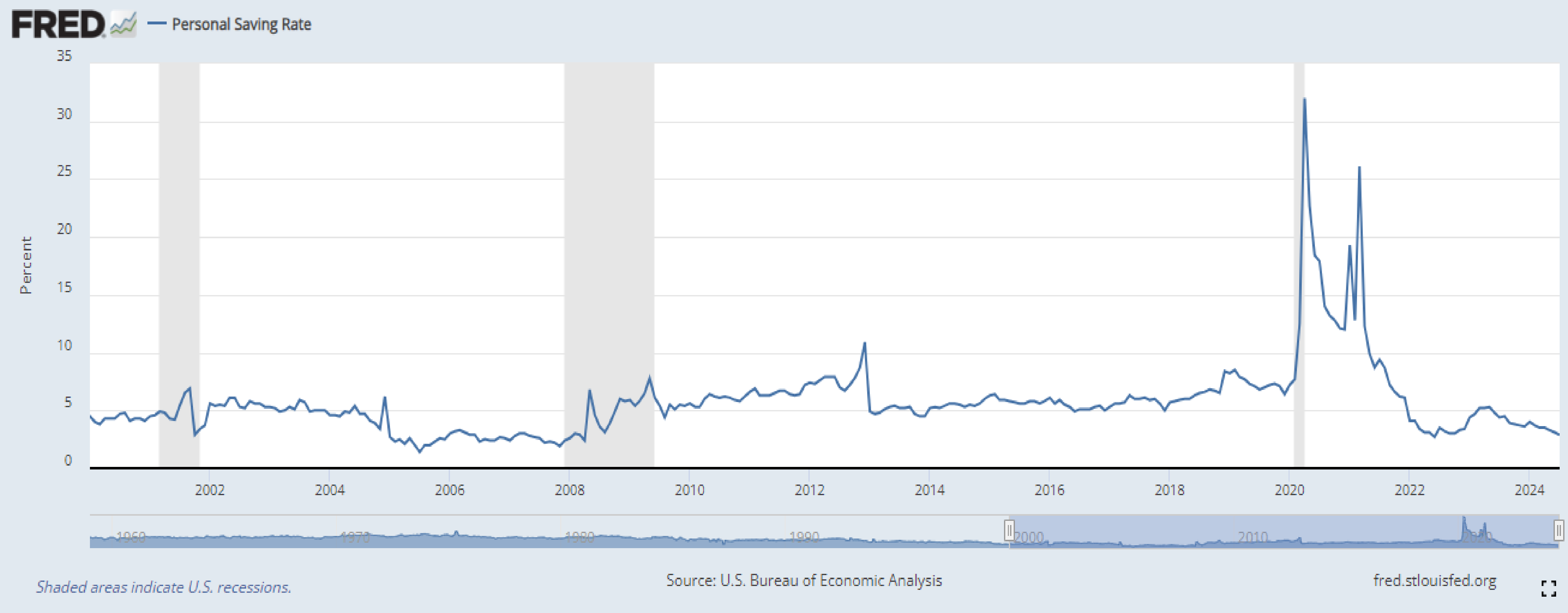

**Source: fred.stlouisfed.org/series/TOTLL#0**

# Growing consumer debt



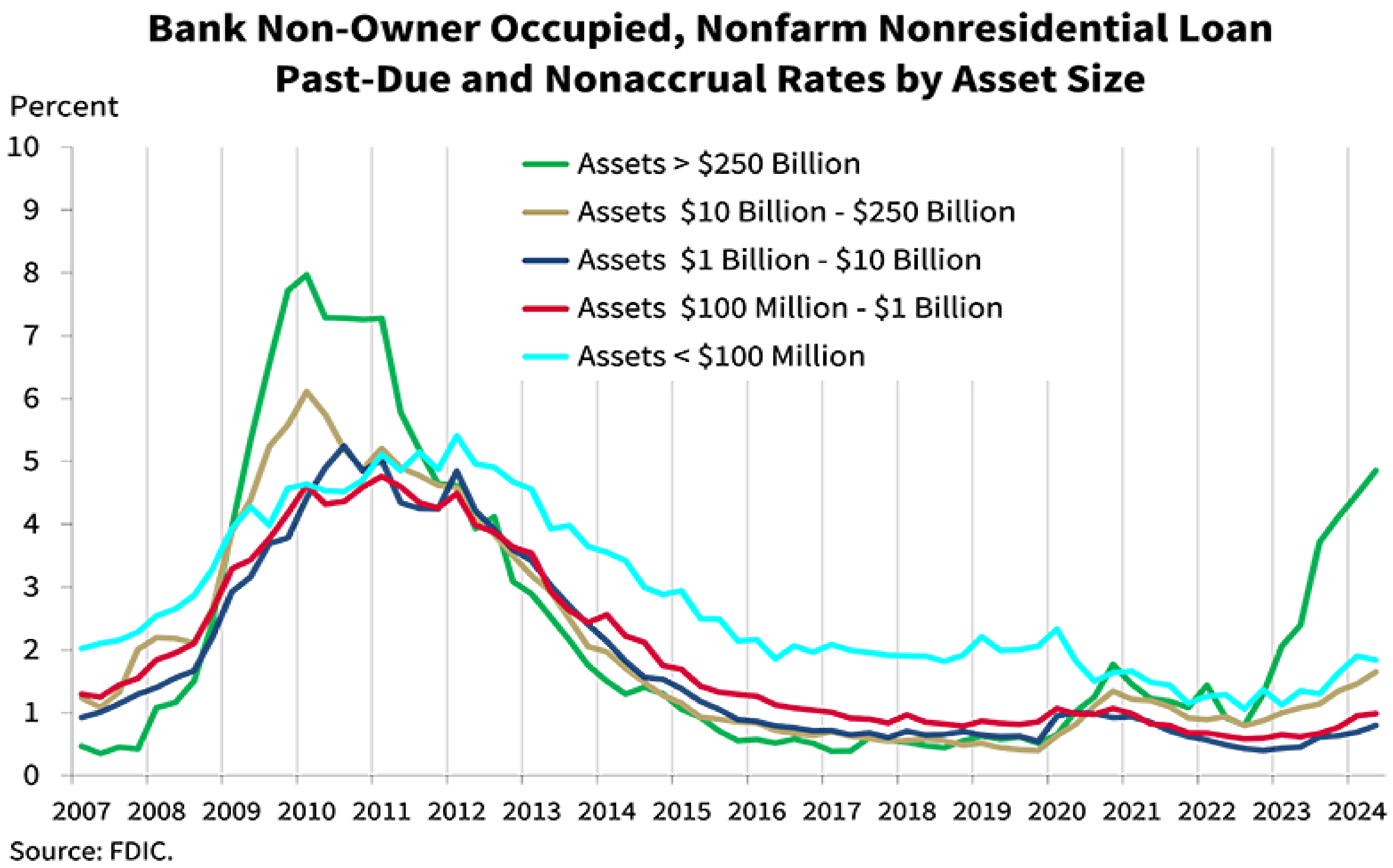

Source: FRED CRE Credit Card and Other Revolving Plans - https://fred.stlouisfed.org/series/CCLACBW027SBOG#

# Personal savings




Source: FRED Personal Savings Rate - https://fred.stlouisfed.org/graph/?g=580A#

# FDIC Quarterly Banking Profile – Q2 2024



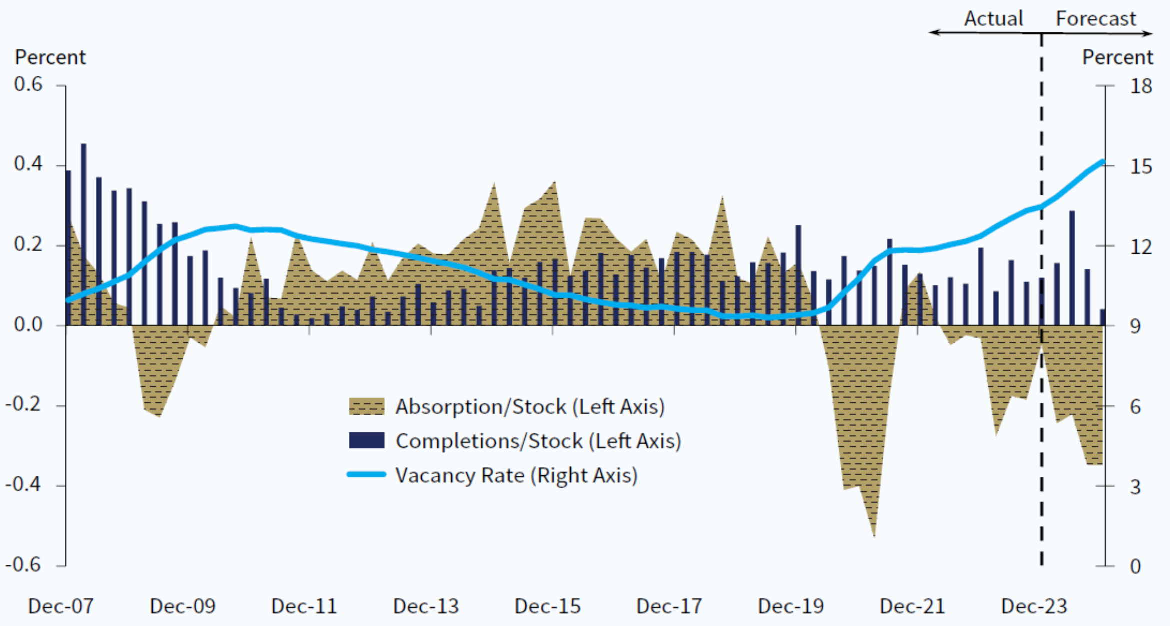

| Asset Size | PDNA Rate | Pre-Pandemic Avg. |
|---|---|---|
| >$250B | 4.85% | 0.59% |
| $10B - $250B | 1.65% | 0.66% |

Source: FDIC.gov

# FDIC 2024 Risk Review – May 2024

CHART 21

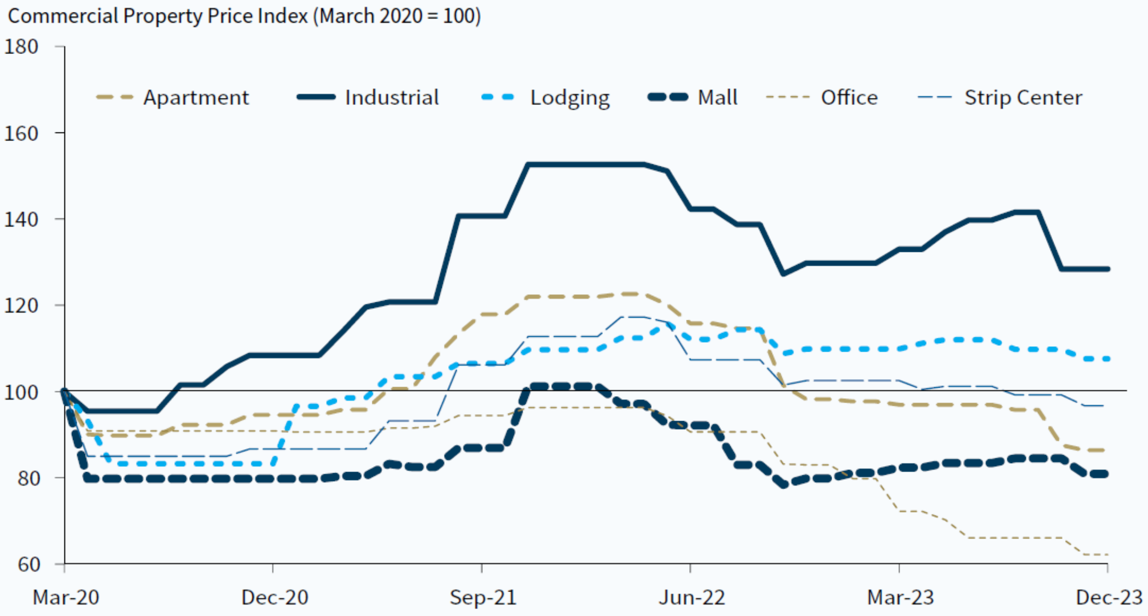
Office Demand Was Weak in 2023 and Is Not Forecast to Improve in 2024




Source: CoStar.
Note: Actual data are quarterly through fourth quarter 2023; the forecast is quarterly through fourth quarter 2024.

CHART 22

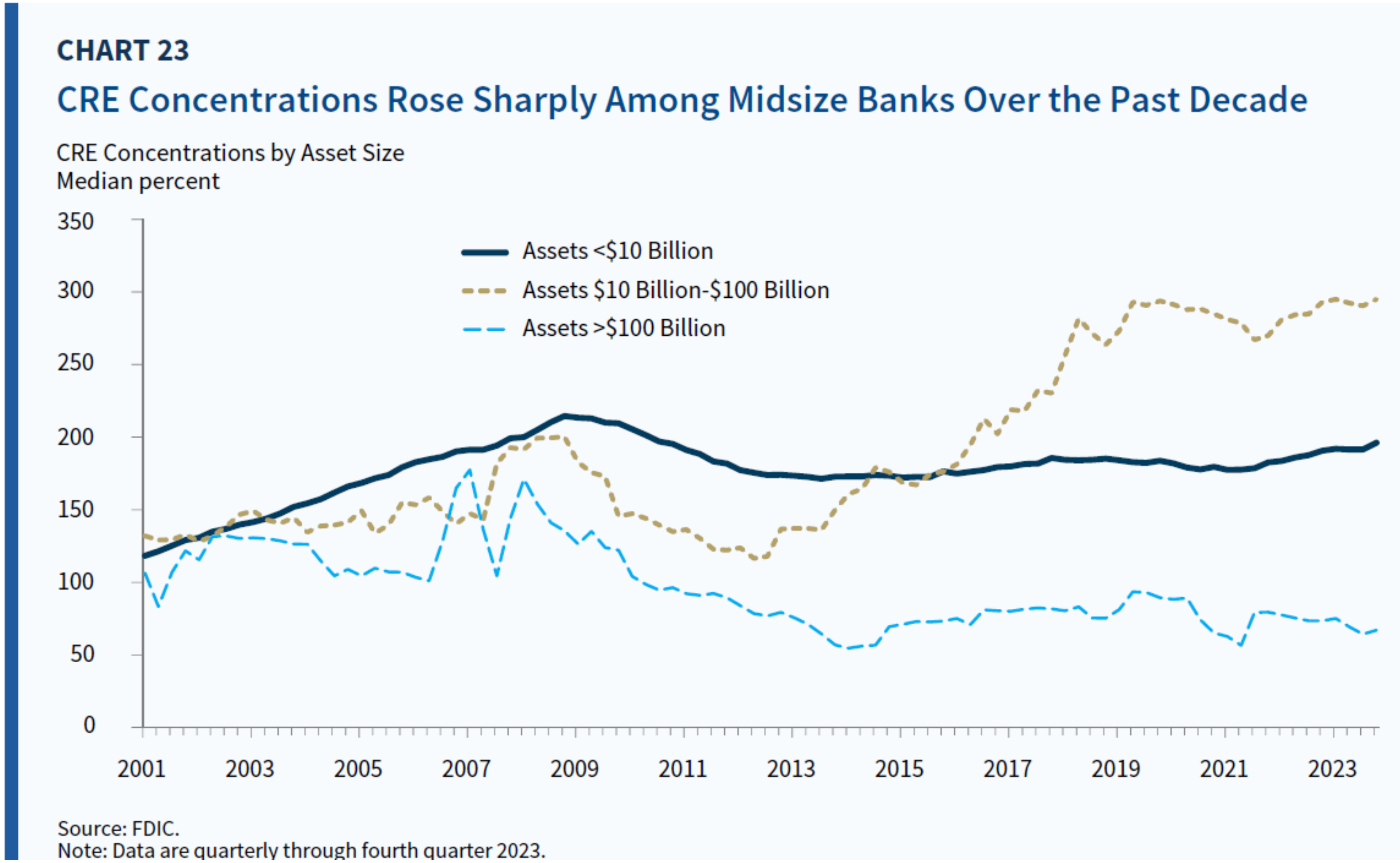
Office and Mall Prices Remained Weak in 2023




Source: Green Street.
Note: Green Street defines Strip Centers as retail properties that are neither malls nor outlet centers. Data are monthly through December 2023.

**Source: FDIC 2024 Risk Review**
**https://www.fdic.gov/analysis/risk-review/2024-risk-review.html**

# FDIC 2024 Risk Review – May 2024




Source: FDIC 2024 Risk Review
https://www.fdic.gov/analysis/risk-review/2024-risk-review.html

# Commercial Real Estate

# CRE

***Football is blocking and tackling everything else is mythology.***

*- Vince Lombardi*

- **Hospitality**
  - Geography matters
  - Urban locations continue to lag some never fully came back from Covid
  - Starting to see softening even in the non-urban areas which had held up well from 2022 thru 2023.
  - Need to collect STR reports and MTD's
  - Need to do inspections & web search make sure no deferred maintenance problems
- **Office Space**
  - Class B & C impacted most
  - Roll over should be closely monitored
  - Tenant concentrations should be monitored
- **Multifamily**
  - Once a darling – cash flows tight out of the gate & lower cap rates causing problems.
  - Rents flattened (some down) in most markets – keep eye on tenant pay behavior.

- **Items to Monitor**
  - Renewals will continue to be a challenge
  - Watch real estate taxes!!
  - Watch Insurance!!
  - Adjust expectations for property level expenses
  - Use your annual review to really focus on what changed since origination (CAP Rate, Cash flow, market)
  - **If property not cash flowing documented guarantor support key**
  - Watch payment & deposit behaviors
  - Watch for softening PSF Rents + large concessions
  - Watch rent rolls closely
  - Be prepared for slower absorptions
- **Other CRE Products**
  - Closely monitor retail especially B&C space
  - On retail monitor single tenant there have been some franchise struggles
  - Data centers hot – (highly specialized)
  - Industrial continues to hold up

# Three Stories: Same Loan

**One of Largest Issues Facing Portfolios**

## 1.) 2014 – Actual

| | |
|---|---|
| Loan Date: | 4/18/2014 |
| Purpose: $4,515M to purchase retail strip center. | |
| Terms: | **4.20%: 20 Yr. Am** |
| Purchase Date: | **4/18/2014** |
| Purchase Price: | **$6,025M** |
| Appraisal Date: | **2/22/2014** |
| Hard Cash In: | **$1,510M** |
| Appraisal Value: | **$6,125M** |
| Appraisal Cap Rate: | **9%** |
| Appraisal As is NOI: | **$551M** |
| Loan to Original Cost: | **74.9%** |
| LTV: | **73.7%** |
| Original Debt Yield: | **12.20%** |
| Original DSCR: | **1.65x** |

Guaranties, Covenants, etc. not part of exercise

**Note the speed of decision**

**Note Hard Cash Fully Extracted**

**This Org "is and always has been Conservative won't go over 75%"**

**Note they stayed true to under 75%, but this transaction was much riskier in 2019**

## 2.) 2019 – Actual

| | |
|---|---|
| Loan Date: | 10/20/2019 |
| Purpose: $5,440M Cash out ($1.5MM) refi same | |
| Terms: | **5.86%: 20 Yr. Am** |
| Purchase Date: | **4/18/2014** |
| Purchase Price: | **$6,025M** |
| Appraisal Date: | **10/15/2019** |
| Hard Cash In: | **$10M** |
| Appraisal Value: | **$7,775M** |
| Appraisal Cap Rate: | **7.25%** |
| Appraisal As is NOI: | **$562M** |
| Loan to Original Cost: | **90.3%** |
| LTV: | **70%** |
| Original Debt Yield: | **10.3%** |
| Original DSCR: | **1.22x** |

Guaranties, Covenants, etc. not part of exercise

**No Policy Exceptions These Two Scenarios**

# Third Story – Today

## 3.) 2024 – Mock

**What 2024 (5Yr) maturity looks like**

| | |
|---|---|
| Loan Date: | 8/1/2024 |
| Purpose: | **Now Maturing $4,608,000** |
| Terms: | **8.70%: 20 Yr. Am** |
| Purchase Date: | 4/18/2014 |
| Purchase Price: | $6,025M |
| **Current Appraisal Cap Rate:** | **8.75%** |
| Last Appraisal As is NOI: | $562M |
| **2023 NOI (100% Lease):** | **$521M** |
| **Implied Updated Value:** | **$5,954M** **(2023 NOI / CAP):** |
| **Implied LTV (Maturing / Implied):** | **77.39%** |
| **Updated Annual Debt Service:** | **$487M** |
| **Updated DSCR New Terms:** | **1.07x** |
| **Updated Debt Yield:** | **11.31%** |

Paydown needed to get LTV in policy (75%): ~**$142,500**

Paydown needed to get DSCR in policy (1.2x): ~**$508,000**

- Cap rate up from 7.25% in 2019 to 8.75%.
- NOI is down due to higher expenses on property (same 100% occupancy).
- If reset to 20-year amortization, DSCR and LTV exception exist without additional paydown.
- If Bank wanted both LTV and DSCR to be in policy $508M paydown would be needed.

**Pay Down or… Multiple Critical Policy Exceptions at Renewal**

# Third Story – What If

**Below scenario looks at:**
**What if bank had a 25-year amortization in 2019 and reset to 25-year in 2024?**

| | |
|---|---|
| Loan Date: | 8/1/2024 |
| Purpose: | **$4,882,000 Now Maturing** |
| Terms: | **8.70%: 25 Yr. Am** |
| Purchase Date: | 4/18/2014 |
| Purchase Price: | $6,025M |
| **Current Appraisal Cap Rate:** | **8.75%** |
| Last Appraisal As is NOI: | $562M |
| **2023 NOI (100% Lease):** | **$521M** |
| **Implied Updated Value:** | **$5,954M** **(2023 NOI / CAP):** |
| **Implied LTV (Maturing / Implied):** | **82.00%** |
| **Updated Annual Debt Service:** | **$480M** |
| **Updated DSCR New Terms:** | **1.09x** |
| **Updated Debt Yield:** | **10.67** |

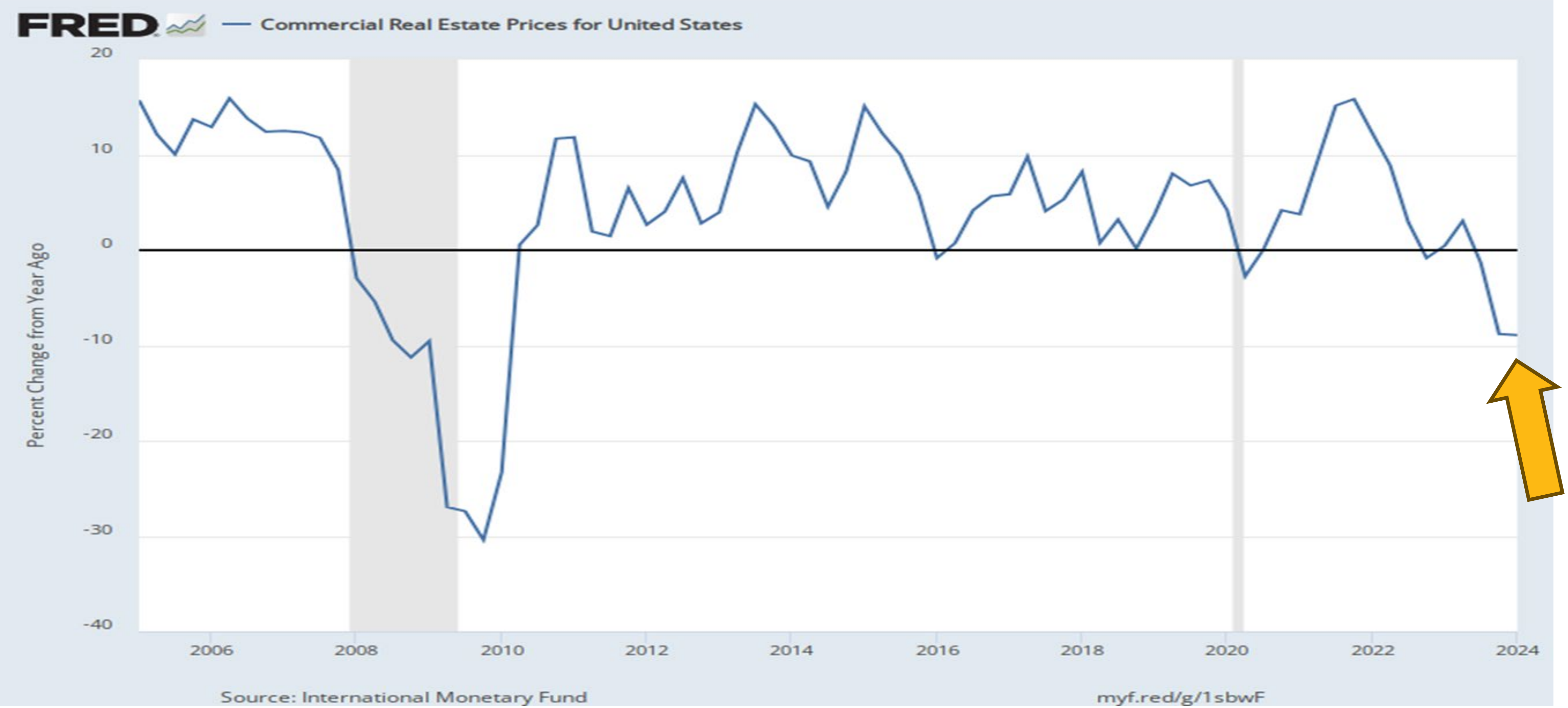
Paydown needed to get LTV in policy (75%): ~**$416,500**

Paydown needed to get DSCR in policy (1.2x): ~**$462,000**

- This shows what happens if the Bank had a 25-year amortization in 2019 instead of 20.
- Also assumes amortization reset at 25 years.
- LTV is of course out of balance more but spreading payments to 25 years makes the DSCR exception less dramatic.

**Pay Down or… Multiple Critical Policy Exceptions at Renewal**

# CRE value changes




Source: FRED CRE Price increases - https://fred.stlouisfed.org/series/COMREPUSQ159N#

# Cap Rates – Office Downtown, Class A Stabilized

| Market | H1 2021 | H1 2023 | H2 2023 | H1 2024 |
|---|---|---|---|---|
| Atlanta | 5.5% - 6.5% | 6.5% - 7.5% | 7.25% - 8.5% | 6% - 7% |
| Chicago | 5.5% - 6.25% | 7.75% - 8.5% | 8% - 9% | 7.5% - 8.5% |
| Houston | 6.5% - 6.75% | 7.25 – 8.25% | 7.75% - 8.5% | 8.75% - 9.5% |
| **Los Angles** | **4.25% - 5.25%** | **7% - 7.5%** | **7.5% - 8.5%** | **8% – 9%** |
| New York | 4.5% - 4.75% | 5.5% - 6.25% | 6% - 6.5% | 6.25% - 7.5% |
| **Oakland** | **4.5% - 5.5%** | **7% - 9%** | **8.5% - 10.5%** | **7% - 7.5%** |
| Philadelphia | 6.5% - 7% | 7.5% - 8.5% | 8.25% - 9.25% | 8.25% - 9.75% |
| **Sacramento** | **6.5% - 7%** | **7% - 7.75%** | **7% - 8%** | **7.5% - 8.25%** |
| **San Diego** | **3.75% - 4.25%** | **7% - 7.5%** | **-** | **8.5% - 9.5%** |
| **San Francisco** | **4.75% - 5.25%** | **6.5% - 7.5%** | **6.75% - 7.75%** | **-** |
| San Jose | 5.5% - 6.5% | 6.5% - 7.5% | - | - |
| Seattle | 4.5% - 5% | 6.25% - 7% | 7.75% - 9% | 8% - 9% |

Moody's
"Office section set a new vacancy record at 20.1%, up from 19.8% in prior quarter" and beating two historic peaks of 19.3% at 1986 and 1991 and crossing 20% for first time ever

$500,000 NOI

Value at 5% Cap Rate $10,000,000

Value at 7.0% Rate $7,142,857

% Change -28.57%



**Source: CBRE Cap Rate Survey. Moody's "Q2 2024 Preliminary Trend Announcement", July 2. 2024.**

# Cap Rates – Retail, Class A Stabilized

| Market | H1 2021 | H1 2023 | H2 2023 | H1 2024 |
|---|---|---|---|---|
| Atlanta | - | 5.5% - 6.5% | 5.25% - 6.25% | 5% - 6% |
| Boston | 5.75% - 6.75% | 6% - 6.5% | 6.25% - 6.75% | 5.75% - 6.5% |
| Chicago | 6% - 7% | 7% - 8% | 6.25% - 7.25% | 6.5% - 7.5% |
| Columbus | 6.5% - 7% | 6% - 7% | 7.25% - 8.25% | 7.25% - 8.25% |
| Houston | 5.25% - 5.75% | 5.5% - 6.5% | 6% - 7% | - |
| Indianapolis | 6.5% - 7.25% | 6% - 7% | 7.25% - 8.25% | 7.25% - 8.25% |
| **Los Angeles** | **4.75% - 5.5%** | **4.25% - 5%** | **-** | **5.5% - 6.25%** |
| New York | 5.5% - 6% | 5.5% - 5.75% | 5.75% - 6.25% | 5.5% - 6.25% |
| Philadelphia | 6% - 7.25% | 6.5% - 7.5% | 6.5% - 7.5% | - |
| Seattle | 5% - 6% | 5.5% - 7% | 5.75% - 7% | 5.75% - 7.25% |

**Source: CBRE Cap Rate Survey**

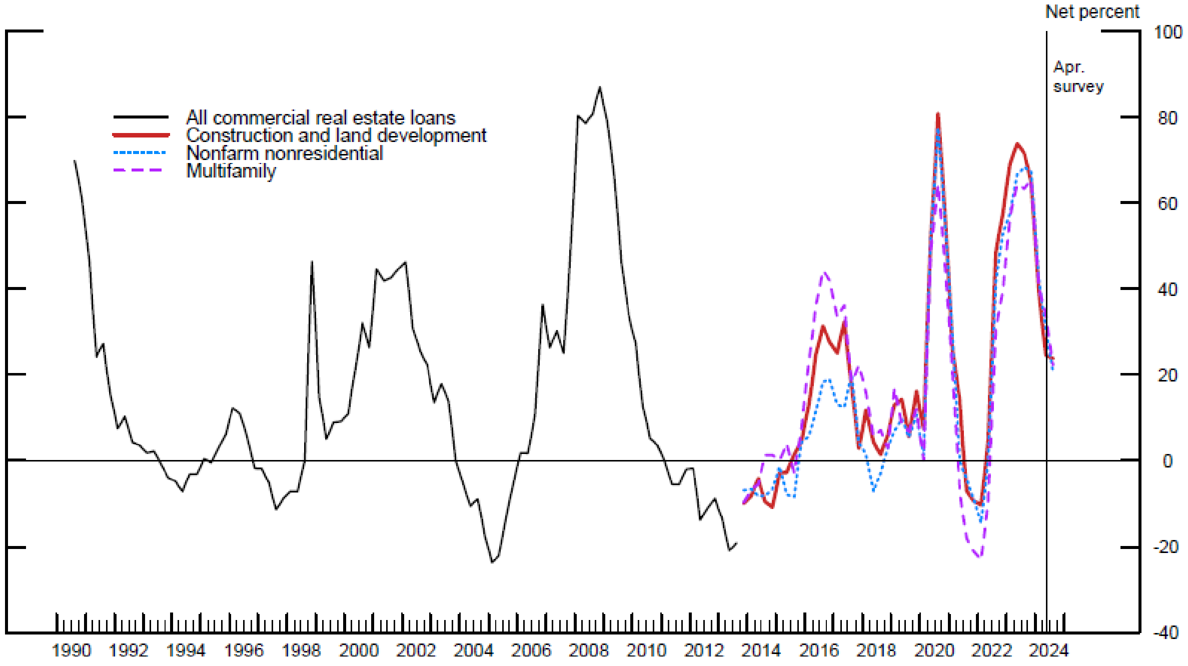
# Cap Rates – Multifamily Infill, Class A Stabilized

| Market | H1 2021 | H1 2023 | H2 2023 | H1 2024 |
|---|---|---|---|---|
| Atlanta | 3.5% - 3.75% | 4.5% - 5% | 5% - 5.5% | 4.75% - 5.5% |
| Chicago | 4% - 4.75% | 5 – 5.5% | 5.5% - 6% | 5.5% - 6% |
| Houston | 3.5% - 4% | 4.25% - 4.75% | 5.25% - 5.75% | 6% - 6.5% |
| **Los Angles** | **4% - 4.25%** | **4.25% - 4.5%** | **5% - 5.5%** | **5.5% - 6.75%** |
| New York | 4.5% - 5% | 4.5% - 4.75% | 5% - 5.5% | - |
| **Oakland** | **4.0% - 4.5%** | **-** | **5.5% - 6.5%** | **5.5% - 6.5%** |
| Philadelphia | 4.75% - 5.25% | 5% - 5.5% | 5.25% - 5.5% | 5.25% - 5.75% |
| **San Diego** | **3.75% 4.25%** | **4.5% - 4.75%** | **4.75% - 5.25%** | **5% - 5.25%** |
| **San Francisco** | **3.5% - 4%** | **4.5% - 5%** | **4.5% - 5.5%** | **4.75% - 5.5%** |
| **San Jose** | **3.75% - 4.25%** | **4.75% - 5.25%** | **5% - 5.5%** | **5% - 5.5%** |
| Seattle | 4% - 4.25% | 4% - 4.5% | 4.75% - 5.25% | 4.75% - 5.25% |

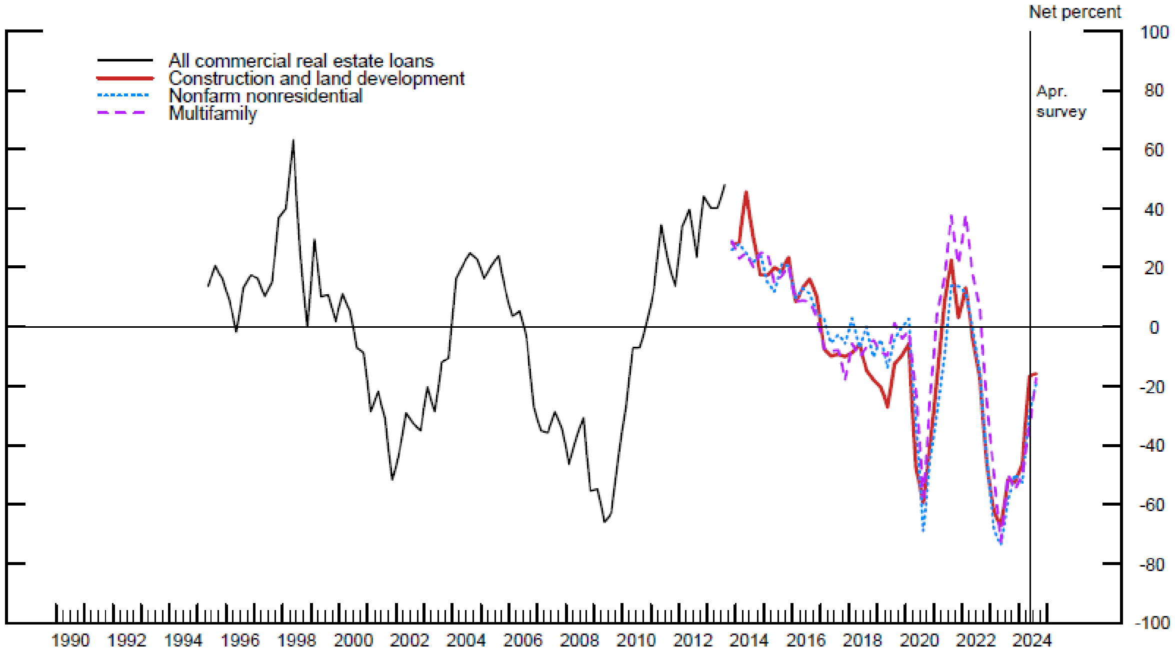
**Source: CBRE Cap Rate Survey**

# Senior Loan Officer survey – July 2024

Net Percent of Domestic Respondents Tightening Standards for Commercial Real Estate Loans




Net Percent of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans




**Source: https://www.federalreserve.gov/data/sloos/sloos-202407.htm**

# PCAOB Spotlight: Auditing Consideration Related to CRE May 2024

**CRE Industry Vulnerabilities:**

- Defaults on commercial mortgages that could impact originators, mortgage servicers, securities purchasers, and providers of risk mitigation products (the ecosystem).
- Unusually competitive rental rates and/or lease incentives.
- Declining property values.
- A substantial volume of office property loans reaching maturity, without a market to refinance such loans.

**Other Challenges:**

- The risk that the impact of these CRE market conditions may also spread to nearby retail space.
- Reduced desirability of living, socializing, and working in densely populated urban mixed-use centers, which may have long-term effects on such CRE.

# PCAOB Spotlight: Auditing Consideration Related to CRE May 2024 – Audit and Review Considerations

- How have interest rates affected the ability of the borrower to make repayment?
- Would lower occupancy rates affect the ability of the borrower to make repayment?
- Does the property depend on a limited number of tenants?
- Are significant tenants experiencing financial difficulties or deciding not to renew their leases or deciding to reduce the square footage they are leasing?
- How have interest rates affected the mortgaged property's value?
- Would lower occupancy rates affect the mortgaged property's value?
- Can the property be economically reconfigured for other purposes?
- Will evolving real estate needs and lessee preferences affect lease renewals?
- Are significant portions of the property's tenants reaching lease maturity? If so, what are the prospects for renewals or new tenants?
- Have assumptions regarding lease renewals changed?
- Have current conditions decreased the value of collateral?
- Are borrowers either not meeting, or at risk of not meeting, covenant requirements?
- Are borrowers able to refinance without a significant capital investment?
- Have collectability issues concerning lease payments increased?

# C&I

# C&I

- **Leveraged Loans**
  - Top of the list for close monitoring
  - Deleveraging has been challenging under higher rates
  - Have watch closely compared to underwriting scenarios
  - Some industries have softened

- **Each Business is Unique**
  - The concept of large scale winners and losers post covid has passed
  - Now the deterioration may be more subtle
  - Need to monitor covenants and incoming statements
  - Client visits may be beneficial

- **Field Exams**
  - For new clients and those that may have growing concerns it may be time to require.

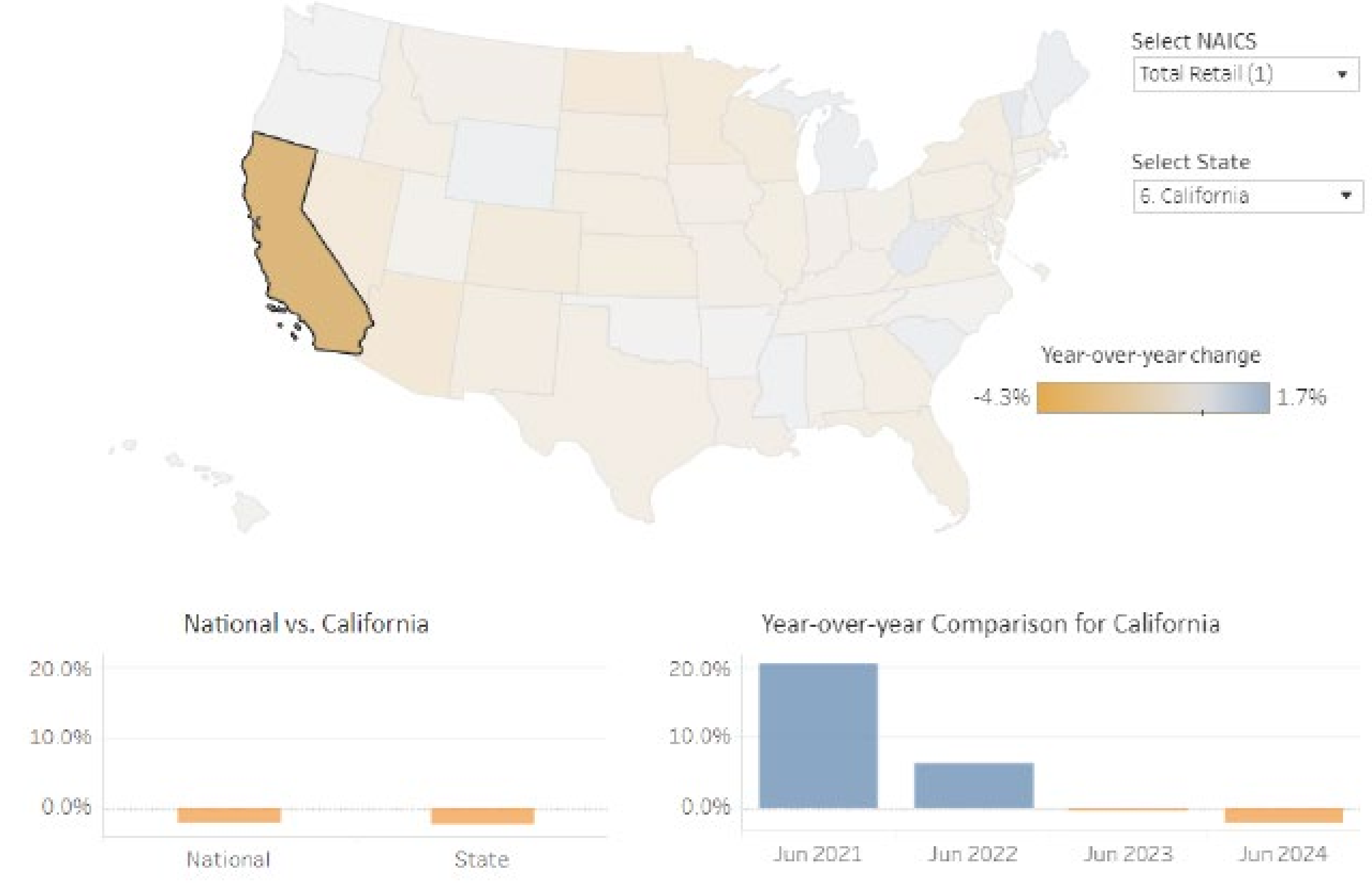
- **Items to Monitor**
  - Concentrations kill(A/R & Sales)
  - Now is good time to focus hard on borrowers with leverage
  - Watch A/R performance closely
  - Watch availability trends
  - Inventory should be watched closely due to build ups
  - Also watch A/P concentrations as well as supplier risks
  - Make sure to assess the borrower based on its current life cycle
  - Make sure reasonable succession plan

- **Other Items**
  - Trucking has been a sensitive area
  - Businesses with close tie to consumer have been sensitive

# Retail Activity

June numbers show softening for the state and country as whole in many pockets:

- 4.3% decline all YOY
- 8.1% decline for auto YOY
- 6.9% decline furniture YOY
- 6.9% decline clothing YOY
- 11.5% decline sporting YOY
- 2% increase food & bev

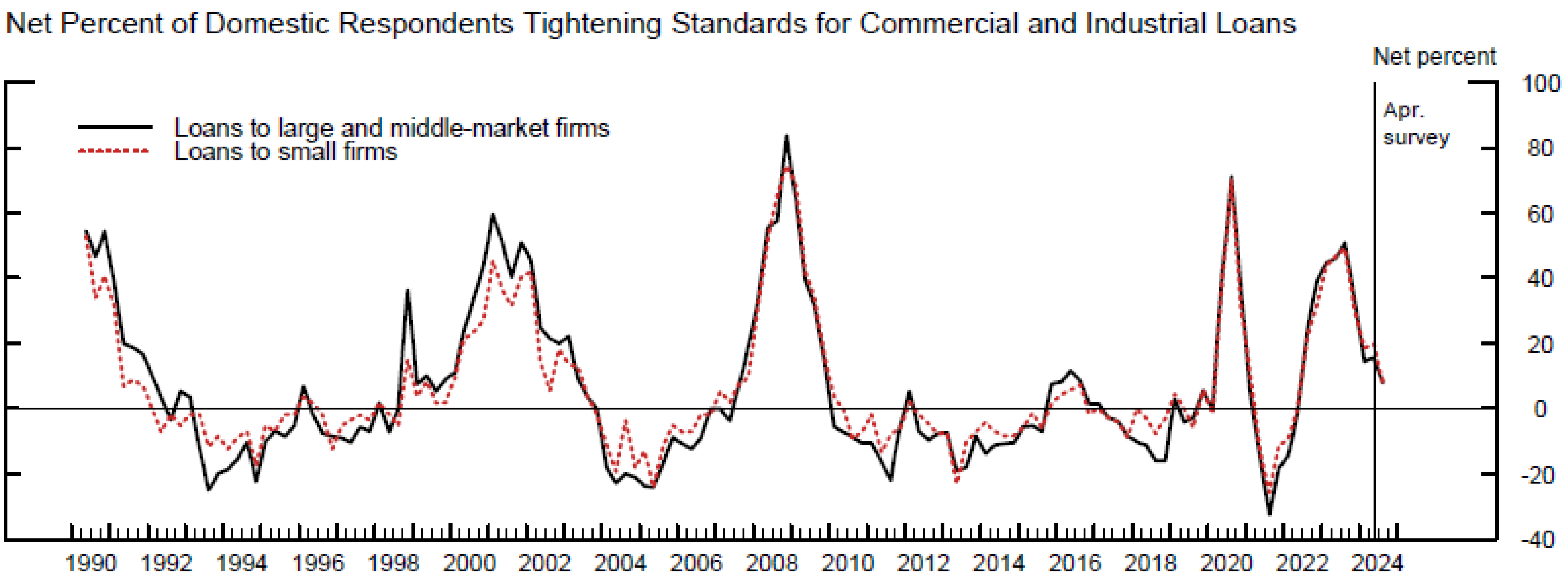



(1) Excluding nonstore retailers

* The 90 percent confidence interval includes zero. There is insufficient statistical evidence to conclude that the actual change is different from zero.
Note: State retail sales data not adjusted for seasonal variation, trading-day differences, moving holidays or price changes.

United States Census Bureau

# Senior Loan Officer survey – July 2024




**Source: https://www.federalreserve.gov/data/sloos/sloos-202407.htm**

# Manufacturing Outlook

## The Manufacturing US Economy At-a-Glance

| | Historical 12/12 | Historical 12MMT/A | Current 12/12 | 2024 | 2025 | 2026 | Highlights |
|---|---|---|---|---|---|---|---|
| US Metalworking Machinery New Orders | | | -0.6 | 3.3 | 4.2 | 1.9 | General New Orders 12MMT rise will persist through at least 2026. The growth will be muted into mid-2025 and then pick up. |
| US Machinery New Orders | | | 0.3 | -0.3 | 5.0 | 4.4 | New Orders will generally plateau this year given divergent machinery markets and then rise in 2025 and 2026. |
| US Construction Machinery New Orders | | | 6.9 | 2.3 | 1.7 | 3.0 | A strong US dollar and elevated rates weigh on New Orders. Marked decline is unlikely given government spending and inflation. |
| US Electrical Equipment New Orders | | | 5.4 | -1.6 | 4.3 | 2.2 | Electrical equipment orders will be hindered by high interest rates impacting construction and industrial markets into early 2025. |
| US Computers & Electronics New Orders | | | 3.1 | -0.9 | 2.0 | 1.4 | The 12MMT will plateau or very mildly decline into the first half of 2025 alongside stagnant B2B activity, then rise through at least 2026. |
| US Defense Capital Goods New Orders | | | -4.0 | 2.7 | -1.9 | 6.7 | The 12MMT will rise briefly. Anticipate mild decline and potential margin pressure for much of 2025 followed by rise in 2026. |
| North America Light Vehicle Production | | | 3.3 | 0.5 | 0.9 | 3.7 | Dealers have raised incentives to attract buyers, but Production will stagnate through mid-2025. The 12MMT will then rise through 2026. |
| US Oil & Gas Extraction Production | | | 5.2 | 2.8 | 2.2 | 4.2 | Production will rise through at least 2026. Lower upstream activity supports our expectation for further Phase C, Slowing Growth. |
| US Mining Production (excluding oil & gas) | | | -4.6 | -4.1 | 2.6 | 2.0 | Production may trend around the lower boundary of the forecast range following a revision from the Federal Reserve Board. |
| US Chemicals & Chemical Products Production | | | 1.1 | -0.2 | 1.2 | 0.9 | Utilization rates and expected business-to-business activity suggest Production will plateau this year. Plan for rise in 2025-26. |
| US Civilian Aircraft Equipment Production | | | -5.5 | 3.1 | 5.7 | 3.1 | A robust backlog suggests room to ramp up Production, if suppliers are able to increase capacity. The 12MMA will rise into late 2025. |
| US Medical Equipment & Supplies Production | | | 0.5 | -1.1 | 0.9 | 0.8 | Phase D, Recession is likely in the near term, but reshoring suggests decline will be mild. Expect mild rise in much of 2025 and 2026. |
| US Heavy-Duty Truck Production | | | 1.6 | -3.9 | 2.7 | 2.6 | Downside pressures will likely outweigh upside pressures into early next year. Expect rise for most of 2025 into mid-2026. |
| US Food Production | | | -1.6 | -0.2 | 1.7 | 1.5 | Upstream agriculture indicators are in Phase A, Recovery. Food Production has formed a flat trough and is likely to rise soon. |

*Note: Forecast color represents what Phase the market will be in at the end of the year.*

**PHASE KEY**

Phase A: Recovery

Phase B: Accelerating Growth

Phase C: Slowing Growth

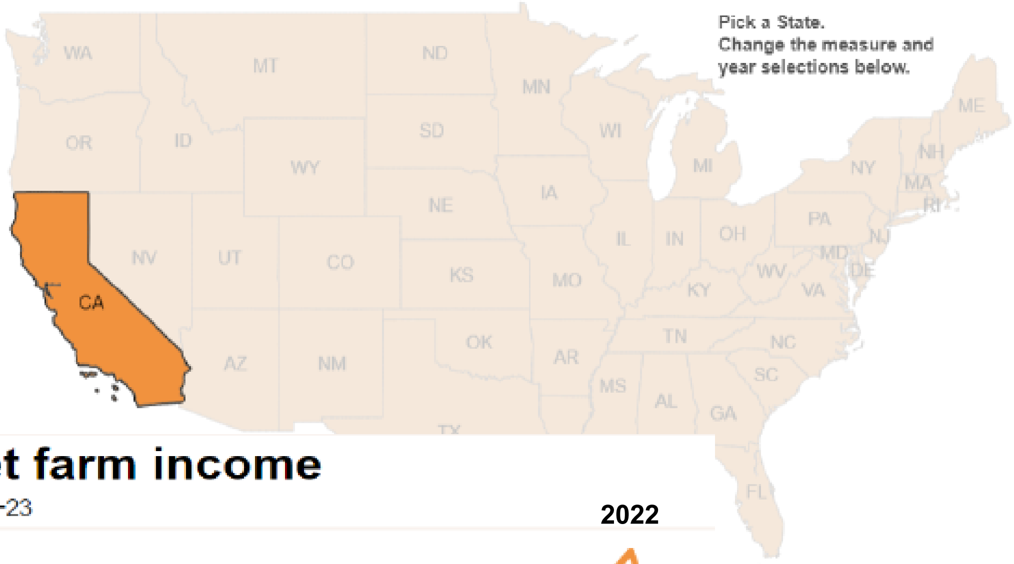
Phase D: Recession

**Source: ITR Economics, A Crowe, LLP Company, Trends Report September 2024: https://itrondemand.com/store/product/insider**

# Agriculture

# California Farm Trends

## Get to know farms in California, 2023




## Farm facts

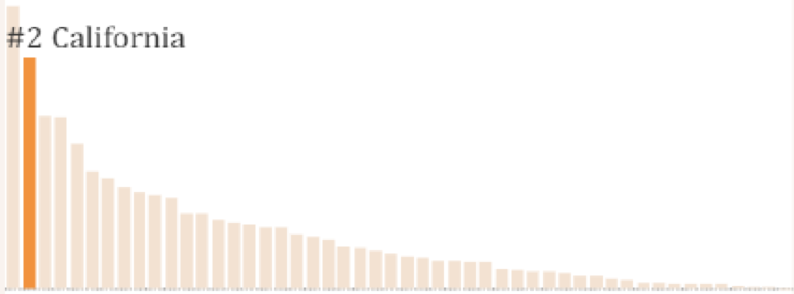
| Number of farms | Acres of farmland |
|---|---|
| 62,900 | 23,800,000 |

| Net farm income | Government payments |
|---|---|
| $12,471,984,000 | $665,503,000 |

| Federal insurance premiums | Federal insurance indemnities |
|---|---|
| $363,592,000 | $1,244,749,000 |

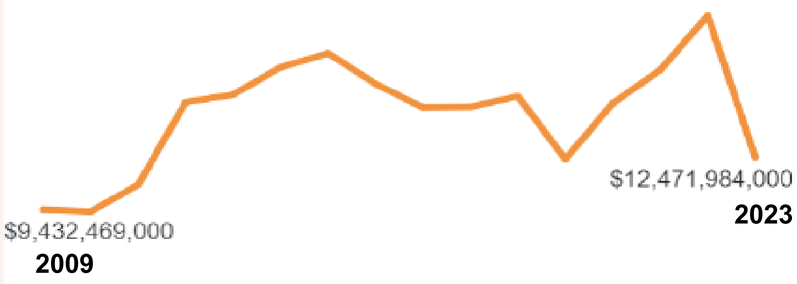
## Ranked by: Net farm income 2023

Net farm income, $2023




## Net farm income

2008–23




## Top 5 cash receipts (2023 dollars)

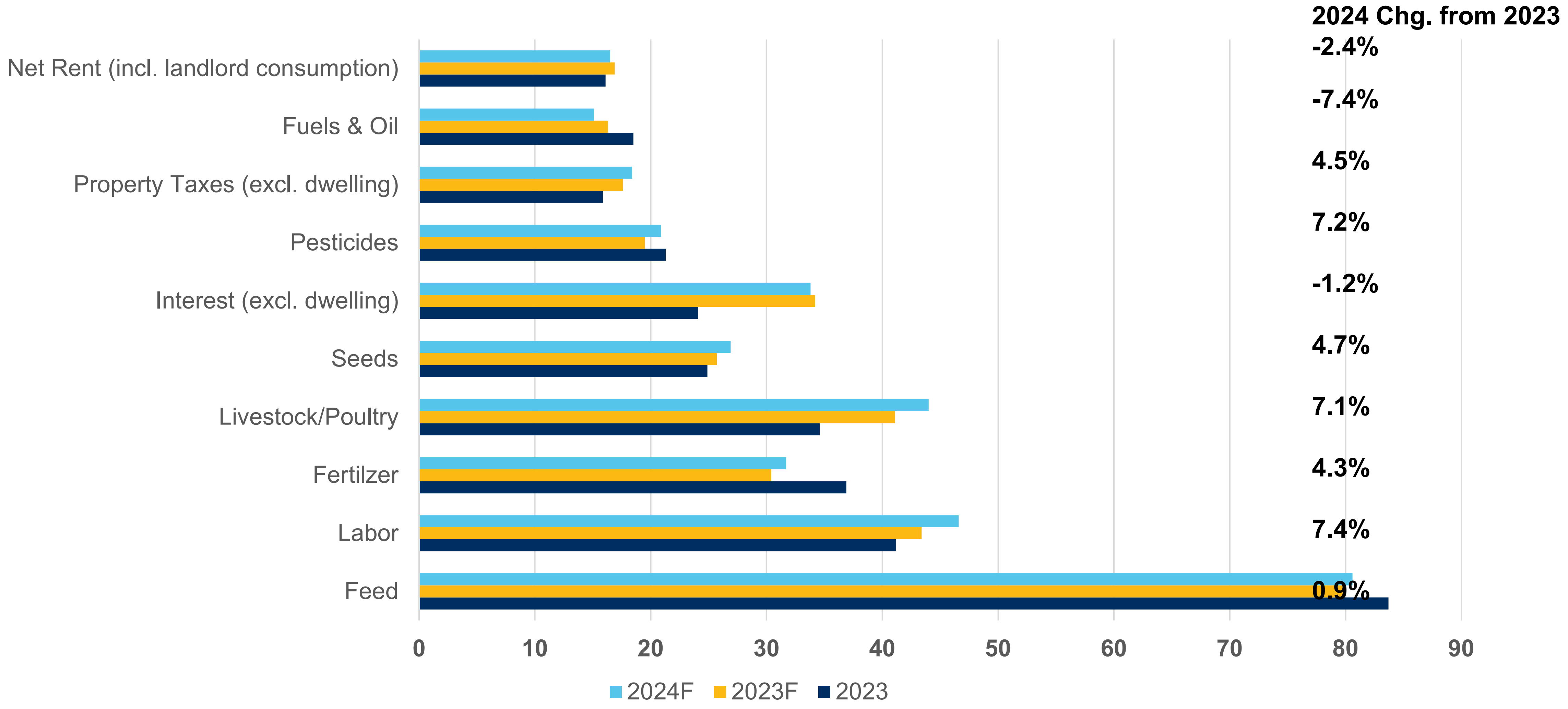
| | | |
|---|---|---|
| 1 | Dairy products, milk | $8,133,926,000 |
| 2 | Grapes | $6,524,474,000 |
| 3 | Miscellaneous crops | $5,427,138,000 |
| 4 | Cattle and calves | $4,763,107,000 |
| 5 | Lettuce | $3,930,867,000 |

## Top 5 production expenses (2023 dollars)

| | | |
|---|---|---|
| 1 | Hired labor | $11,863,017,000 |
| 2 | Miscellaneous* | $6,193,779,000 |
| 3 | Feed | $4,940,000,000 |
| 4 | Contract labor | $4,036,997,000 |
| 5 | Fertilizer, lime, & soil conditioner | $3,160,000,000 |

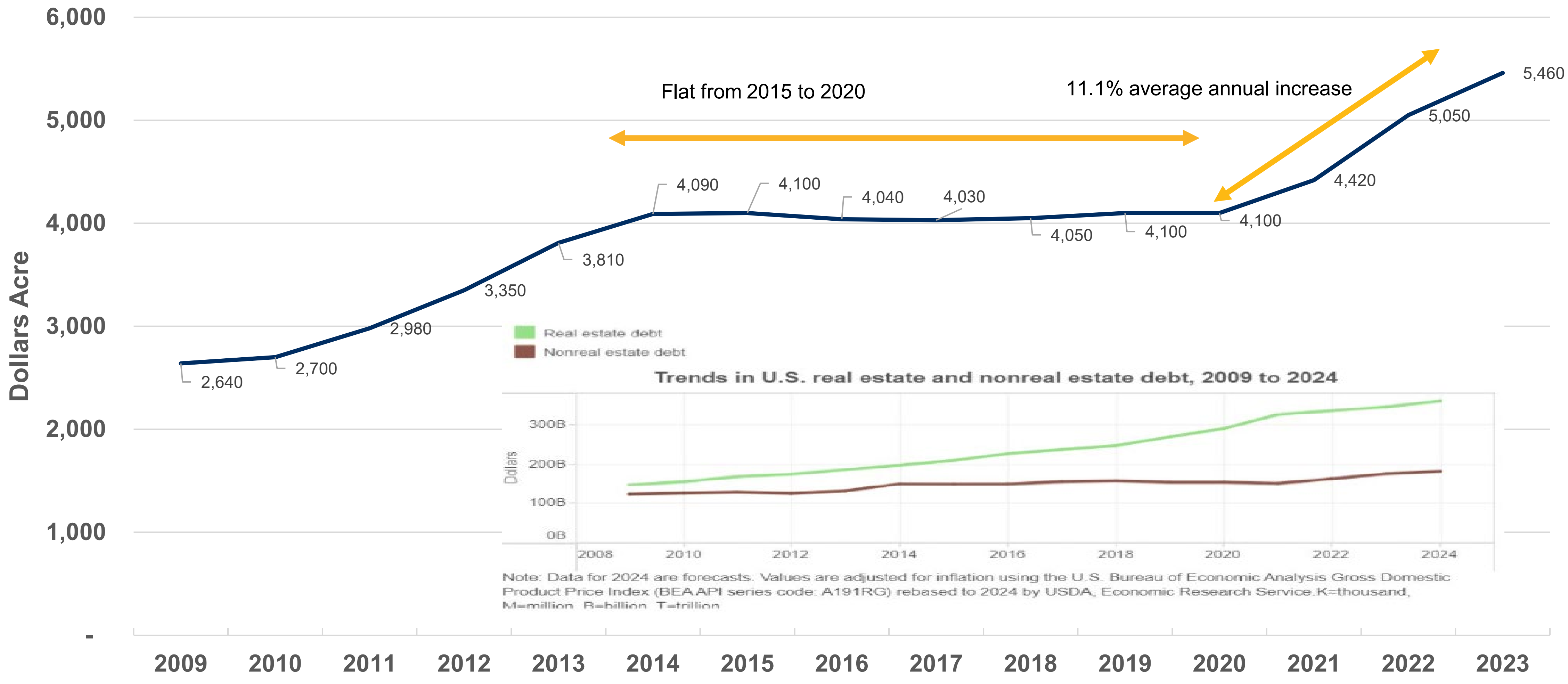
**Source: USDA, Economic Research Service, Farm Income and Wealth Statistics**

# Farm Sector Expenses – U.S.



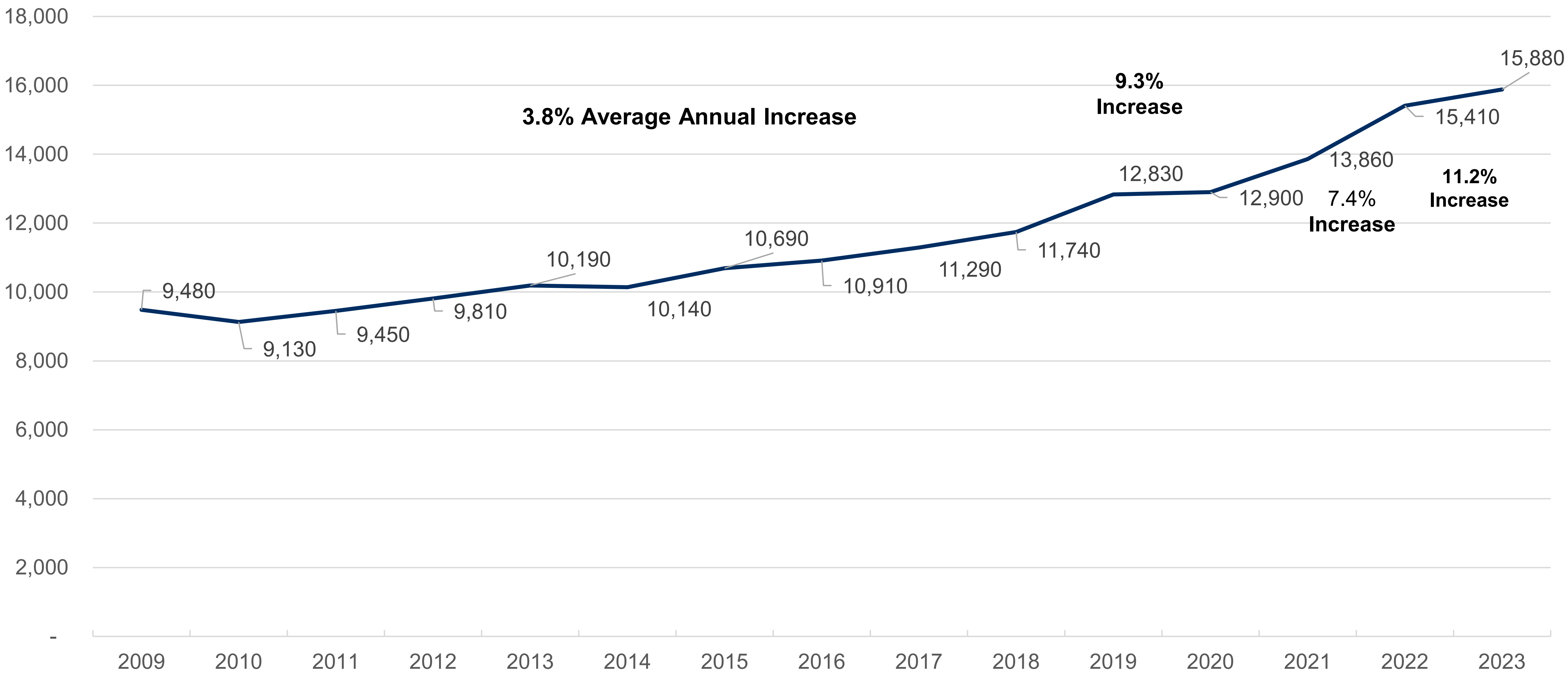

**Source: USDA, Economic Research Service, Farm Income and Wealth Statistics**

# Average Cropland Values – U.S vs Debt.



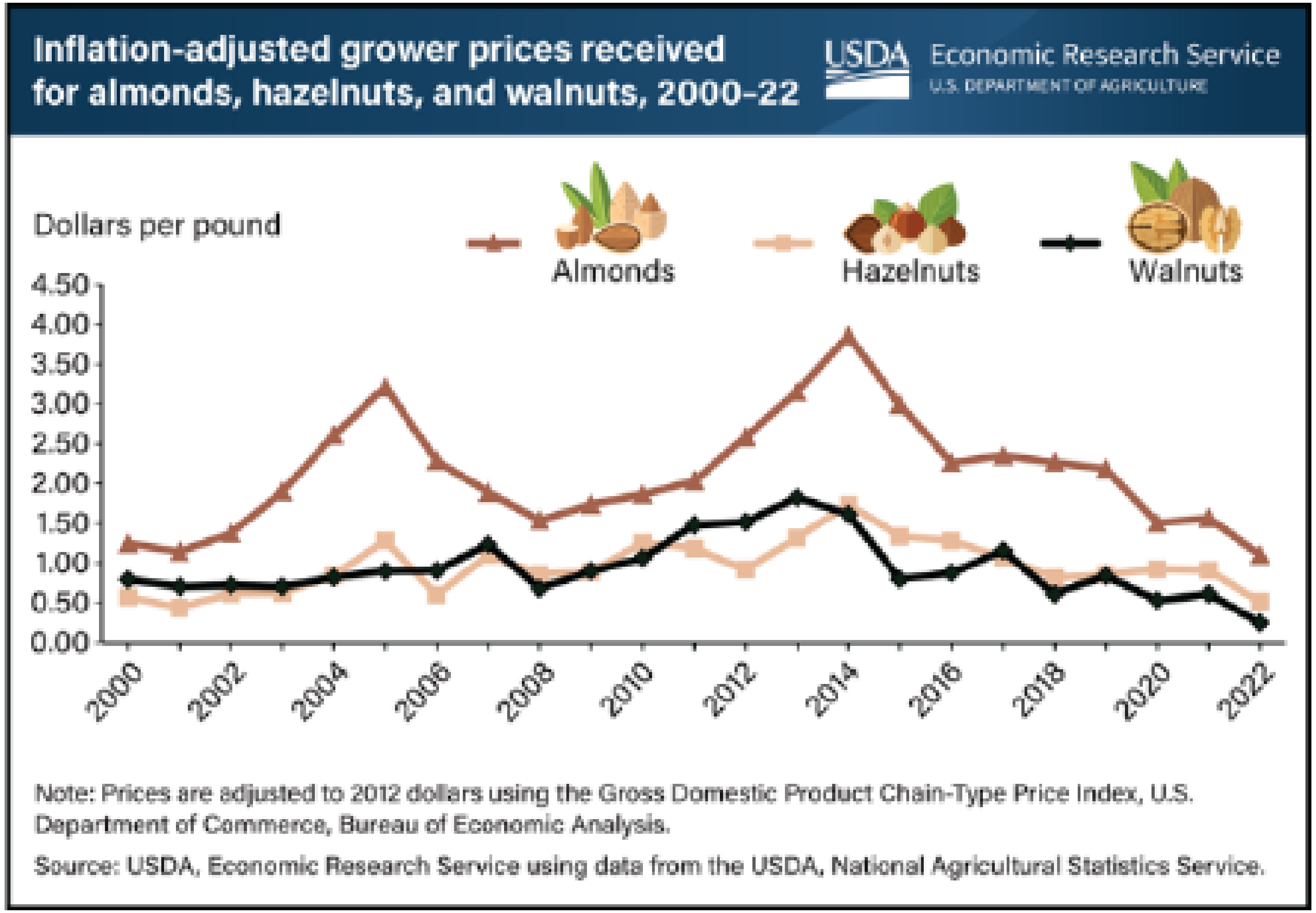

**Source: USDA, Economic Research Service, Farm Income and Wealth Statistics**

# Average Cropland Values – California




**Source: USDA, Economic Research Service, Farm Income and Wealth Statistics**

# Prices for some Key Crops Soft




*“The 2024 California walnut production is forecast at 670,000 tons, down 19% from 2023's production of 824,000 tons”:*

**USDA 2024 Walnut Objective Measurement Report**

**Source: USDA, Economic Research Service, Farm Income and Wealth Statistics**

# Closing Thoughts

# Closing Thoughts

## Wrapping it up

### Loan Review

- You should feel challenged right now !!
- Now is great time to consider upping game
  - Talk through depth of review (not just grading focus)
  - Ask if you are getting value add comments
  - Are you seeing challenge on grades?
  - What is scoping / risk assessment process?
  - If one visit, is multiple more prudent (fast moving times)
  - Are you getting feedback on problem loans / process?
- Next level process is important if you have a heightened CRE concentration
- Are visual analytics part of the process? – Should be

### Fresh Information is Key

- You need to stay on your reporting requirements in this environment
- On each borrower (especially large or increased PD) should assess if should be collecting information more frequently

### Use Both Lagging and Forward-Looking Indicators

- MIS should be fluid (ad hoc or new items)
- Now is good time to sit back and reflect on data being presented to committee / board for any gaps
- Get outsider thoughts if needed
- Is the correct amount of economic data being presented
- Any additional policy exception, portfolio metrics, trends, forward-looking items to add

# OCC – Semiannual Risk Perspective Spring 2024

Credit Risk is listed first..

**CREDIT RISK** is increasing. Commercial real estate (CRE) sectors, primarily the office sector and some multifamily property types, are experiencing stress due to a higher-rate environment and structural changes. Office and multifamily loans, particularly those with interest-only terms, set to refinance over the next three years pose additional risk. Sticky inflation and elevated interest rates may increase financial stress in some households and weigh on overall consumption growth.

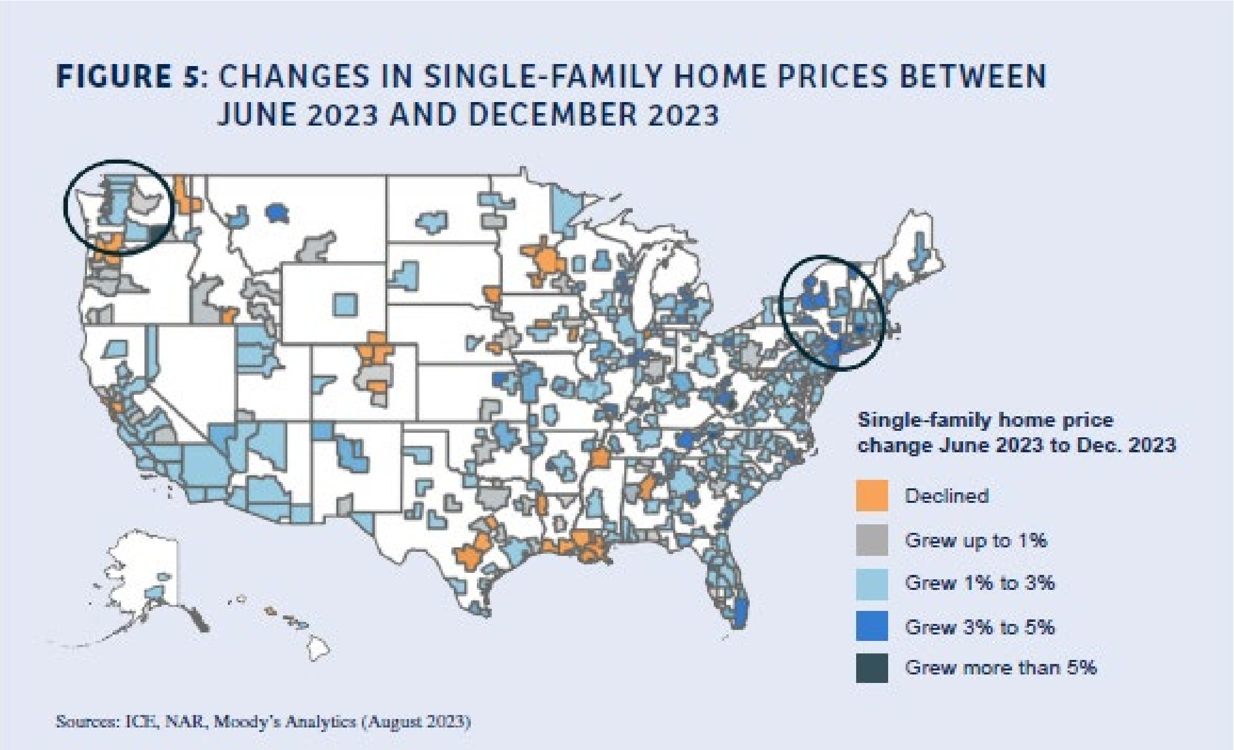
***OTHER Credit Related Comments:***

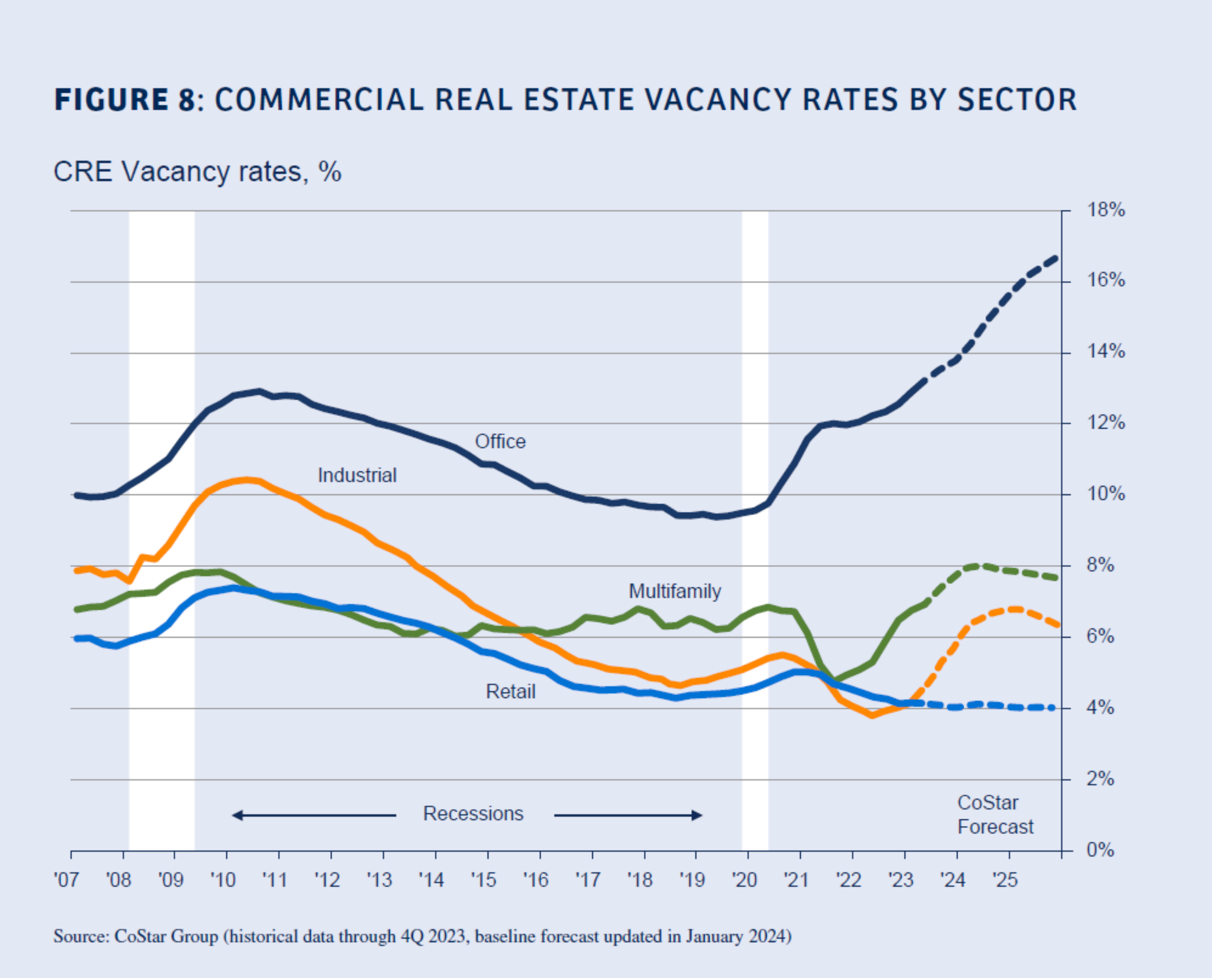
- CRE loan growth slowed, but concentrations continue to present heightened risk. Expenses, including utilities, property insurance, and taxes, are rising. Risk in the office market remains high and has expanded beyond urban business districts.
- Risk in multifamily is increasing due to a variety of stressors. Broadly, rising interest rates, insurance costs, and other expenses are resulting in increased operating costs for many multifamily property owners
- In areas with rent control regulations, such as New York City and California, buildings with rent-regulated units might experience greater NOI compression. Some parts of the southern and western United States, such as Nashville and Salt Lake City, are experiencing overbuilding in luxury properties.
- Other CRE property types remain sound but show signs of softening. In general, retail properties have stabilized, but regional malls and retail shops that depend on in-office workers continue to struggle.

*“The current operating environment remains challenging and could strain the resources of credit risk review and loan workout functions. Retirements and other attrition, coupled with an extended benign credit period, have decreased the number of credit risk professionals with problem loan identification and mitigation experience. It is important for banks to ensure that staffing plans for workout functions are adequate”*

**Source: https://www.occ.gov/publications-and-resources/publications/semiannual-risk-perspective/files/pub-semiannual-risk-perspective-spring-2024.pdf**

# OCC – Semiannual Risk Perspective Spring 2024




**Source: https://www.occ.gov/publications-and-resources/publications/semiannual-risk-perspective/files/pub-semiannual-risk-perspective-spring-2024.pdf**

Crowe

# Thank you

**Giulio Camerini**

Principal, Financial Services Consulting
Giulio.Camerini@crowe.com