C&I Lending Trends 2015

Submitted by Vince Van Nevel on February 23, 2016

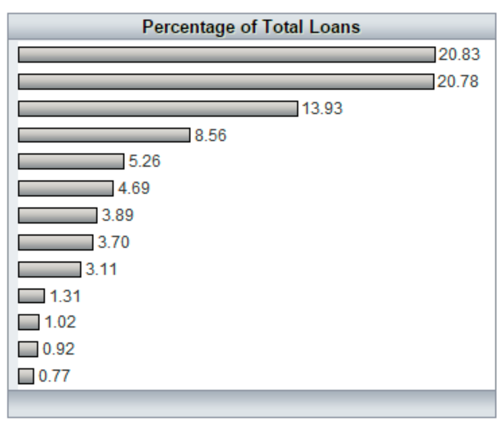
Red Sky at Morning, Sailors Take Warning

For the first time ever, total outstanding commercial & industrial loans exceed total 1-4 family first lien loans, and stand at a record $1.842 trillion as of December 31, 2015. Total 1-4 family first lien loans stood at $1.836 trillion. If this was a horse race, C&I loans won by a nose! However, there may be a storm just over the horizon.

Many years ago when I lived in Chicago working for the OCC, I was certified to sail 30 foot sailboats on Lake Michigan. That is when I first heard of the rhyming weather rules of thumb, the other being “red sky at night, sailors delight.” The “on the water” portion of the certification was primarily spent learning how to depart from and return to the dock without destroying the boat. They wanted to know we could captain the ship safely and that we knew what we were doing; their version of risk management.

I was doing some research on loan trends to write an article on the current regulatory emphasis on risk management and strategic planning. That is, if your strategic plans include goals for adding new products or growing existing products, they want to know if you have performed appropriate risk assessments to identify and control risks in these products (i.e. do you know what the heck you’re doing?). When I saw a recap of fourth quarter 2015 Call Report results, including the historical trend in C&I loans, I put that article on the back burner and jumped on this one. The following trends are of significant interest, especially given recent regulatory admonitions of relaxed underwriting, presumably to attract some much sought after loan growth. Here are the standings at year-end 2015:

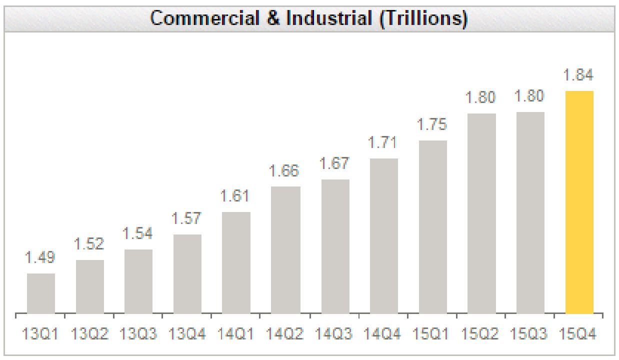
#	Loan Portfolio	Loan Amount	% Tot Ln	90PD+NA
1	Commercial & Industrial	1,841,653,942,000	**20.83**	0.78
2	1-4 Family First Liens	1,836,440,153,000	**20.78**	4.26
3	Commercial Real Estate	1,231,207,832,000	**13.93**	0.86
4	Individuals: Credit Cards	756,465,174,000	**8.56**	1.15
5	Home Equity Loans	465,106,619,000	**5.26**	2.67
6	Individuals: Auto Loans	414,810,354,000	**4.69**	0.30
7	Multifamily Residential RE	344,054,165,000	**3.89**	0.28
8	Individuals: Other Loans	326,682,249,000	**3.70**	0.86
9	Construction & Development	274,924,159,000	**3.11**	1.12
10	Lease Financing Receivables	115,816,857,000	**1.31**	0.35
11	Farmland Loans	90,365,436,000	**1.02**	1.01
12	Farm Loans	81,487,426,000	**0.92**	0.44
13	1-4 Family Junior Liens	68,035,042,000	**0.77**	3.16
		7,847,049,408,000	**88.77**	

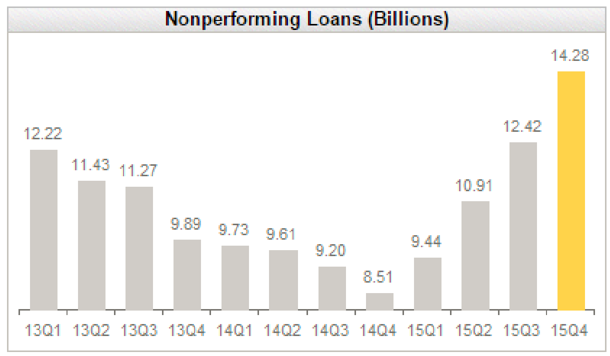


Source: Call Reports; BankRegData.com

So, C&I loan totals now exceed 1-4 family first lien loans. What's the big deal? Well, it could be a very big deal as it appears some banks may not know what the heck they are doing. C&I growth continues onward and upward at the same time that nonperforming levels and net charge offs on these same loans are on the rise. Red flags in the nautical sense can mean dangerous cargo on board or, at the beach, high hazard and/or dangerous riptides, water closed to public. We may have some red flags flying for C&I loans!

Let's take a peek at what your regulators are going to be looking at when they stop by for a friendly visit: C&I loans are on the rise AND the quality of C&I loans appears to be on the decline, as shown in the graphs below.



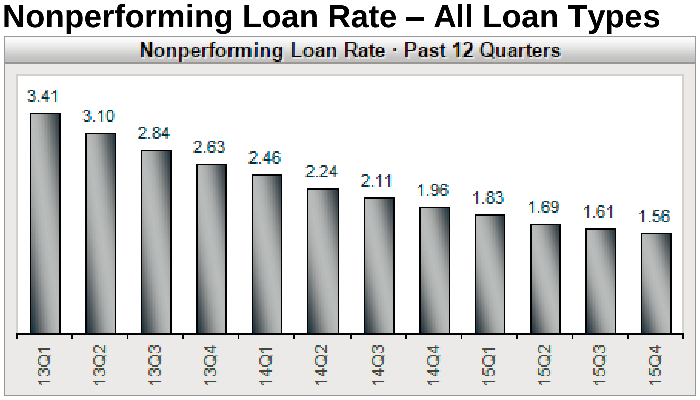


Source: Call Reports; BankRegData.com

C&I nonperforming loans almost doubled from the low of $8.5 billion just one year earlier at December 31, 2014, to $14.28 billion as of year-end 2015. As a percent of total outstanding C&I loans, nonperforming increased from 0.50% to 0.78% over that same period. This will get the regulators' attention and, if you are making these types of loans, they will want to see if it has gotten yours.

The C&I trend is going against the grain of overall loan quality trends. Total nonperforming loans of all loan types at all banks have decreased almost 50% from $261.2 billion at March 31, 2013 to $137.8 billion as of December 31, 2015. The graph on total nonperforming loan rates shown below reflects this favorable trend for all loan types at all banks.

Nonperforming Loan Rate – All Loan Types

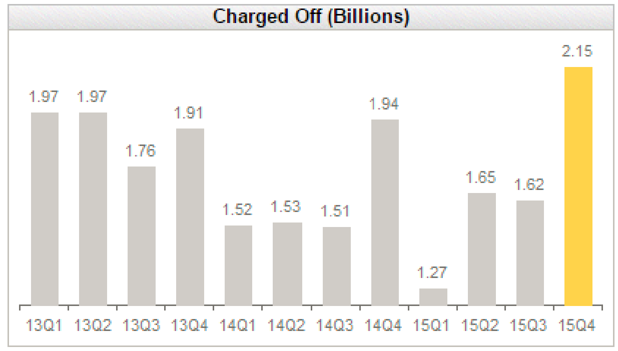


Source: Call Reports; BankRegData.com

Moreover, the volume of nonperforming C&I loans continued to increase despite the highest level of gross charge offs in recent years, as shown below.

Gross C&I Charged Off Loan $'s – All Banks

While the dollar volume of charged off C&I loans is increasing, the charge off rate of 0.47% as of December 31, 2015 is lower than that of 0.49% at December 31, 2013 given C&I growth. Nonetheless, the nonperforming and charged off trends could indicate some underwriting issues with C&I loans originated in prior periods. The examiners will be assessing your underwriting practices. You should be too.

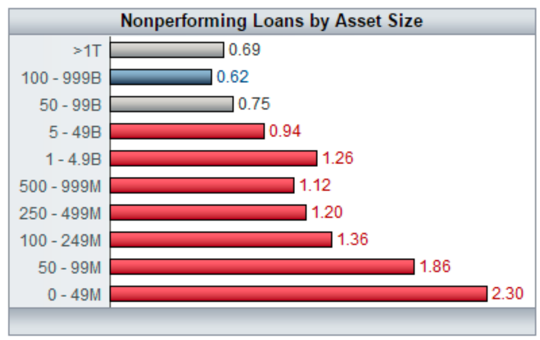


Any more good news? Well…

You are probably thinking that all those nonperforming loans and charged off dollars are in the mega banks. It is true that the dollars are in the largest banks. But as a percent of C&I loans outstanding, the community banks are worse off. This is reflected in the following graphs.

Nonperforming C&I Loans by Asset Size

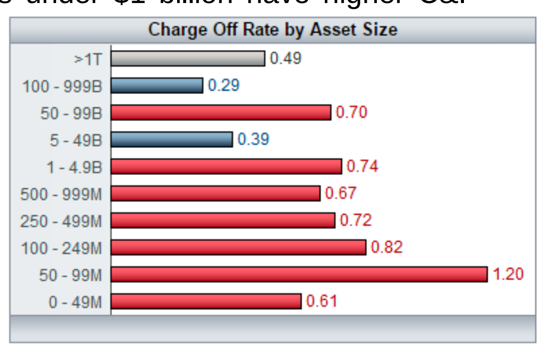
Asset Size	# Inst	Comm & Ind	Nonperforming	Perc
>1 Trillion	4	680,492,473,000	4,703,260,000	0.69
100-999 Billion	20	518,608,029,000	3,199,951,000	0.62
50-99 Billion	15	166,855,527,000	1,246,360,000	0.75
5-49 Billion	147	271,264,979,000	2,562,047,000	0.94
1-4.9 Billion	491	101,989,560,000	1,288,925,000	1.26
500-999 Million	651	41,841,837,000	469,417,000	1.12
250-499 Million	1,117	31,629,733,000	378,559,000	1.20
100-249 Million	1,815	22,896,512,000	310,265,000	1.36
50-99 Million	949	4,838,424,000	89,855,000	1.86
0-49 Million	573	1,236,868,000	28,484,000	2.30
	5,782	**1,841,653,942,000**	**14,277,123,000**	**0.78**



Source: Call Reports; BankRegData.com

C&I Charge Off Rate by Asset Size

As a percent of holdings, all bank groups with total assets under $1 billion have higher C&I nonperforming rates and higher charged off rates than the mega banks. It is hard to tell at this point but some of this decline may be tied to the problems in the energy sector and banks that lend to them and/or ancillary businesses.



So, not to totally forget about risk management, if your loan portfolio holds any meaningful volume of C&I loans, or if you have made plans to grow in this loan type (or any other for that matter), a robust risk assessment should be in order to identify key risk indicators, your institution's risk appetite, and translate that into policy and procedural control points. Of course, make sure you have the front and backroom expertise to engage in such lending, as well as appropriate monitoring and reporting mechanisms in place. More on this later. Happy lending!