Credit Quality & Red Flags for Deteriorating Loans

July 29, 2026

Agenda

1. Introduction
2. Current Credit Quality
3. Real Estate Metric Updates
4. Problem Loans
5. The Response
6. Case Studies
7. Closing

Introduction

Presenter

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Andrew is a key member of the Loan Review practice unit, where he leads engagements for a diverse range of financial institutions, including those with over $20 billion in assets. He specializes in evaluating loan portfolios to assess borrower creditworthiness and the effectiveness of credit administration practices, including SBA portfolios. Andrew also leads efforts related to loan securitization support.

He has completed several industry-recognized programs, including Moody's Commercial Loans to Small Business, The Risk Management Association's Commercial Lending School, and the Indiana Bankers Association's Advanced Agricultural Conference. His continued professional development includes additional specialized training in lending and credit management.

Andrew is a Credit Risk Certified (CRC) professional through The Risk Management Association and has authored multiple articles on credit risk, including SBA lending.

He holds a B.S. in finance from Indiana University Bloomington and a M.B.A. from Purdue University, West Lafayette.

Presenter

Jack D'Ambrosia

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Jack is a member of Forvis Mazars' Loan Review practice, serving New England & other northeast states from offices in Boston & Cape Cod. His career in the financial services industry spans +30 years, beginning as an examiner with the OCC. Focusing on credit risk management, Jack works with community banks and credit unions, encompassing various asset classes, with emphasis on commercial lending.

Jack is a board member & the treasurer of a charitable organization which provides housing & life skills learning to homeless adults on Cape Cod (HnH).

He is a graduate of the University of Notre Dame with a BBA in Finance.

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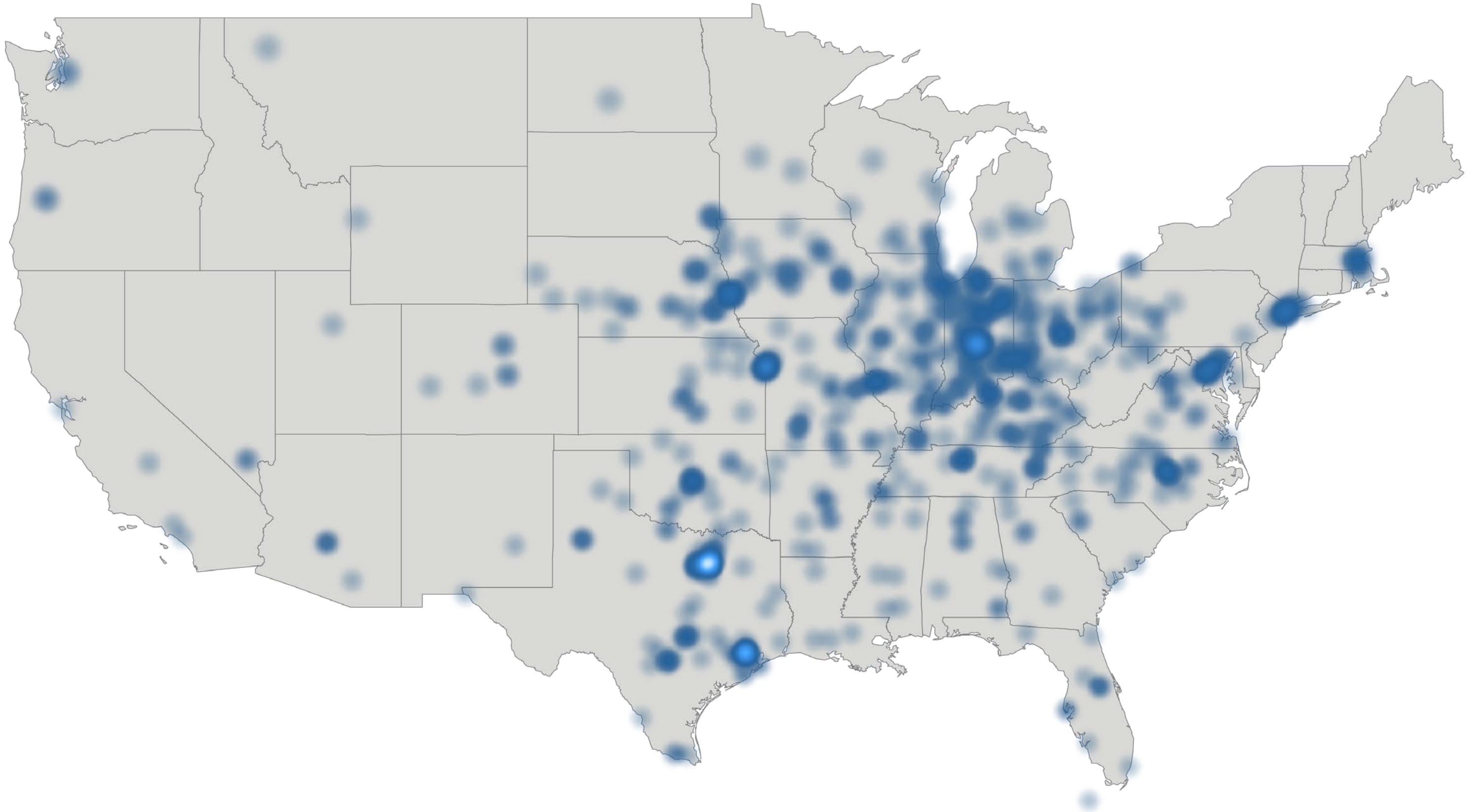
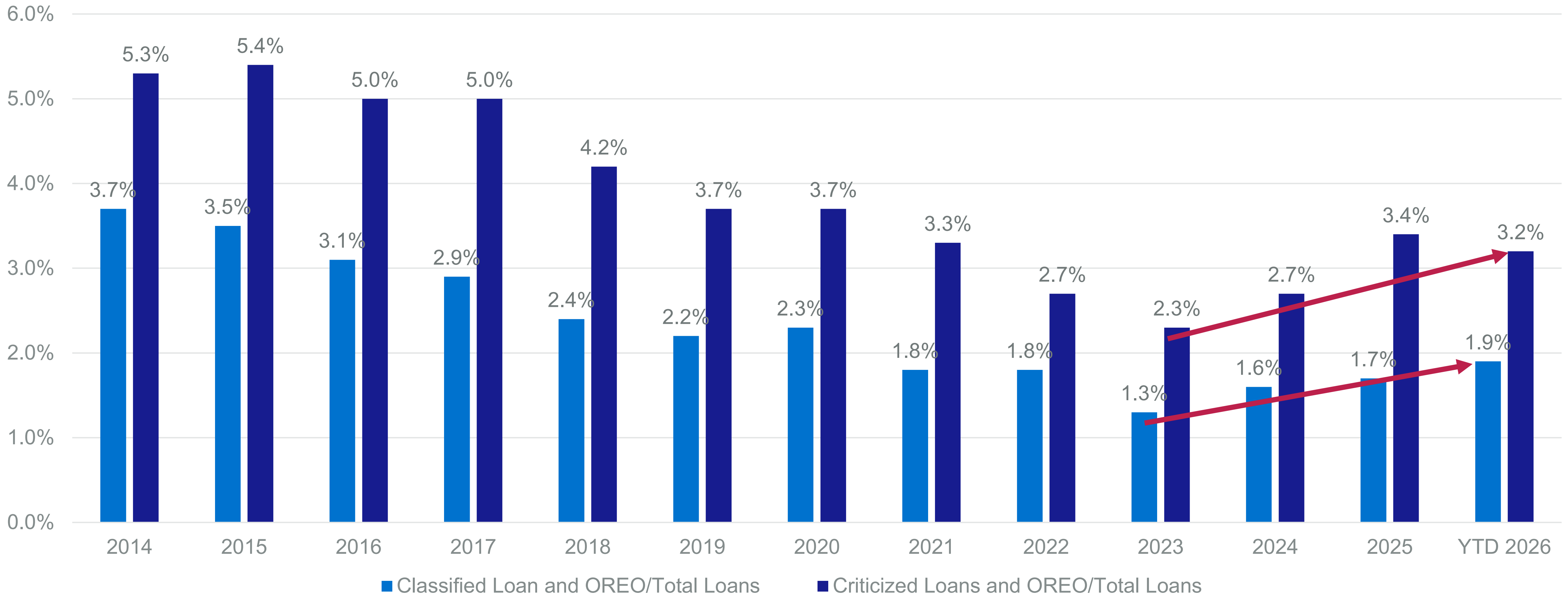


Credit Quality

Problem Loans as a Percent of Total Loans
Across Our National Practice's Client Base



Is the Sky Falling?

The Headlines

Boom or Bust: The State of the U.S. Economy

Orange County real estate investor pleads not guilty in $100-million bank fraud case

The AI Boom Is Opening Up Commercial Real-Estate Investing to New Risks

Spending on data-center construction is poised to surpass office-building construction for the first time, changing the nature of property investing.

JAN 14, 2026, 1:05 PM EST COMMERCIAL REAL ESTATE

Amazon signs massive lease in suburban Mass.

Blackstone Buys Another $2 Billion in Discounted Commercial Real-Estate Loans

The private-equity firm has bought $20 billion in commercial property debt in the last 24 months.

Big lenders finally swallow huge losses on distressed commercial real estate

Commercial Real Estate Is Getting Too Cheap to Ignore

After years of low returns, some portfolio managers are rethinking their commercial-property holdings.

Rising Bankruptcy Filings Signal Increased Risk for Creditors in 2026

JUL 13, 2026

HEARD ON THE STREET

Consumer Loans Are Getting Harder to Tally—and the Risks Harder to Gauge

Tracking borrowing gets complicated when more lending is funded beyond banks and public markets.

Commercial Builders Are Losing Their Appetite to Build Anything but Data Centers

Spending on data-center construction is expected to rise by 23% in 2026, while the building of offices, hotels and apartments is seen declining slightly.

Regulators issue new guidance on bank lending risk tied to borrowers living illegally in US

July 13, 2026 | Associated Press

JAN 15, 2026, 12:49 PM EST COMMERCIAL REAL ESTATE

Boston office portfolio sells at 75% discount

America Has a Credit Card Problem, Just Not the One You Think

Hiring slows sharply, curbing recent job-market momentum

Hiring slowed sharply in June even as the unemployment rate fell, curbing some of the budding momentum in job growth this year.

July 2, 2026

Private Credit Can Bring Risk Along With Liquidity to Commercial Property Finance

Private-credit firms tend to accept much higher loan-to-value ratios than banks, raising default risks, Moody's says.

Sources: Wall Street Journal, Boston Globe, Boston Business Journal, LA Times, Chicago Tribune, S&P Global, Indianapolis Star, NY Times

Actually, No … Not Yet

Problem loan percentages remain below pre-pandemic levels

Credit risk remains manageable in aggregate. Past-dues, nonaccruals & net charge-offs remain below long-term averages in most loan portfolios. However, Credit conditions & refi risk in certain segments of CRE & Private Credit markets warrant ongoing monitoring.

Indicators of retail credit performance have generally improved in the past year as exposure to higher-risk consumer lending segments remains manageable.

What We're Seeing

Credit quality has generally remained stable, though the rise in interest rates, inflation, labor costs, tariffs & general economic uncertainty are negatively impacting commercial borrowers' ability to repay

…and the consumer is under fire

Recent loan review engagements have observed:

- An increase in Watch List borrowers per client & Loan Review
- More TLMs
- ↑ Risk grade changes → updated financials driving DGs
- More general discussion [concern] around sampled borrowers

What We're Hearing

Examiners have focus on:

- More conservative grading
- Clearly identifying the intended primary source of repayment vs. shifting grade justifications over time
- Well-defined weakness vs. potential weakness
- Applying Special Mention grade more frequently (& using as a transitionary grade)
- The practice of timely risk ratings, annual reviews…ongoing risk measurement / grade adjustment
- Collection of current financial information
- Adequate staffing in the Credit Department…resources commensurate with risk
- Understanding sponsor / guarantor's contingent debt
- What is driving growth?

Real Estate Metrics & Update

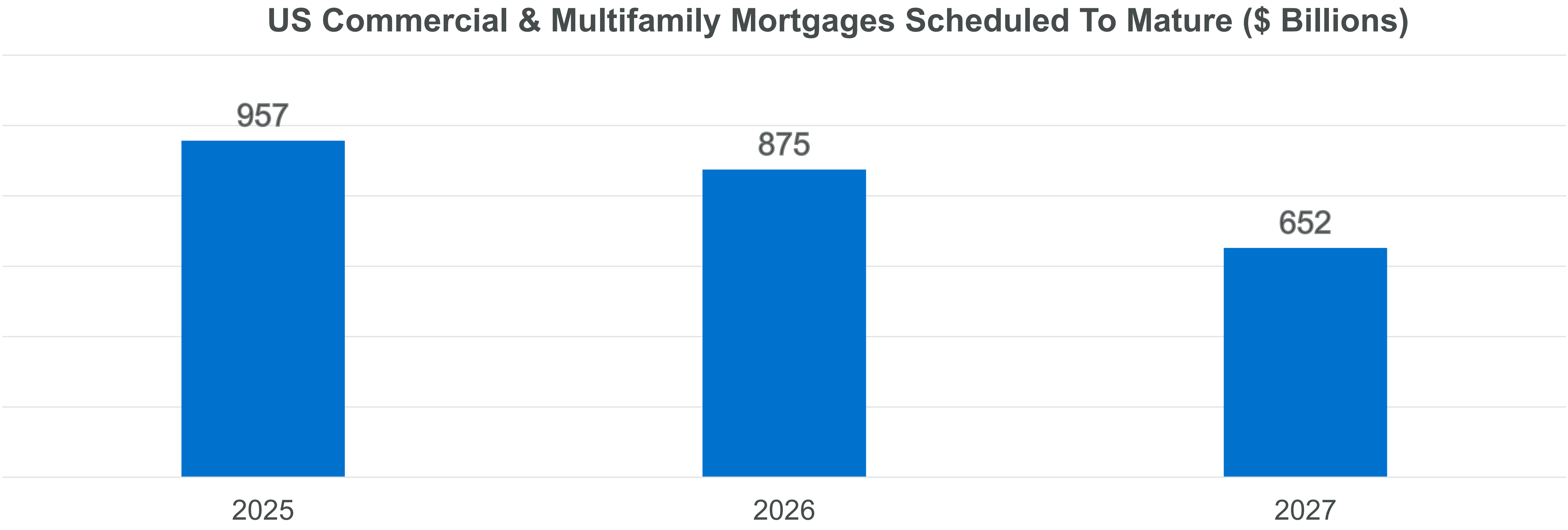
Where’s the Risk

It depends …

- **Certain property types still experiencing headwinds** … though credit defaults are not off the charts. Refi risk compounds strain where demand is off.
- **Still high volume of CRE loans** originated at low rates maturing in coming years, to be refinanced at (higher) prevailing rates.
- **Action will be key.** Extensions make sense when providing a bridge to a better place per reasonable expectations. But often are a kick of the can …

Commercial Real Estate

Loan Maturities



Source: Mortgage Bankers Association 2025 CRE Survey of Loan Maturity Volumes
Released Feb. 2026; balances as **of Dec. 31, 2025**
Held by lenders and investors; $5.0T total outstanding

CRE Vacancy Rates

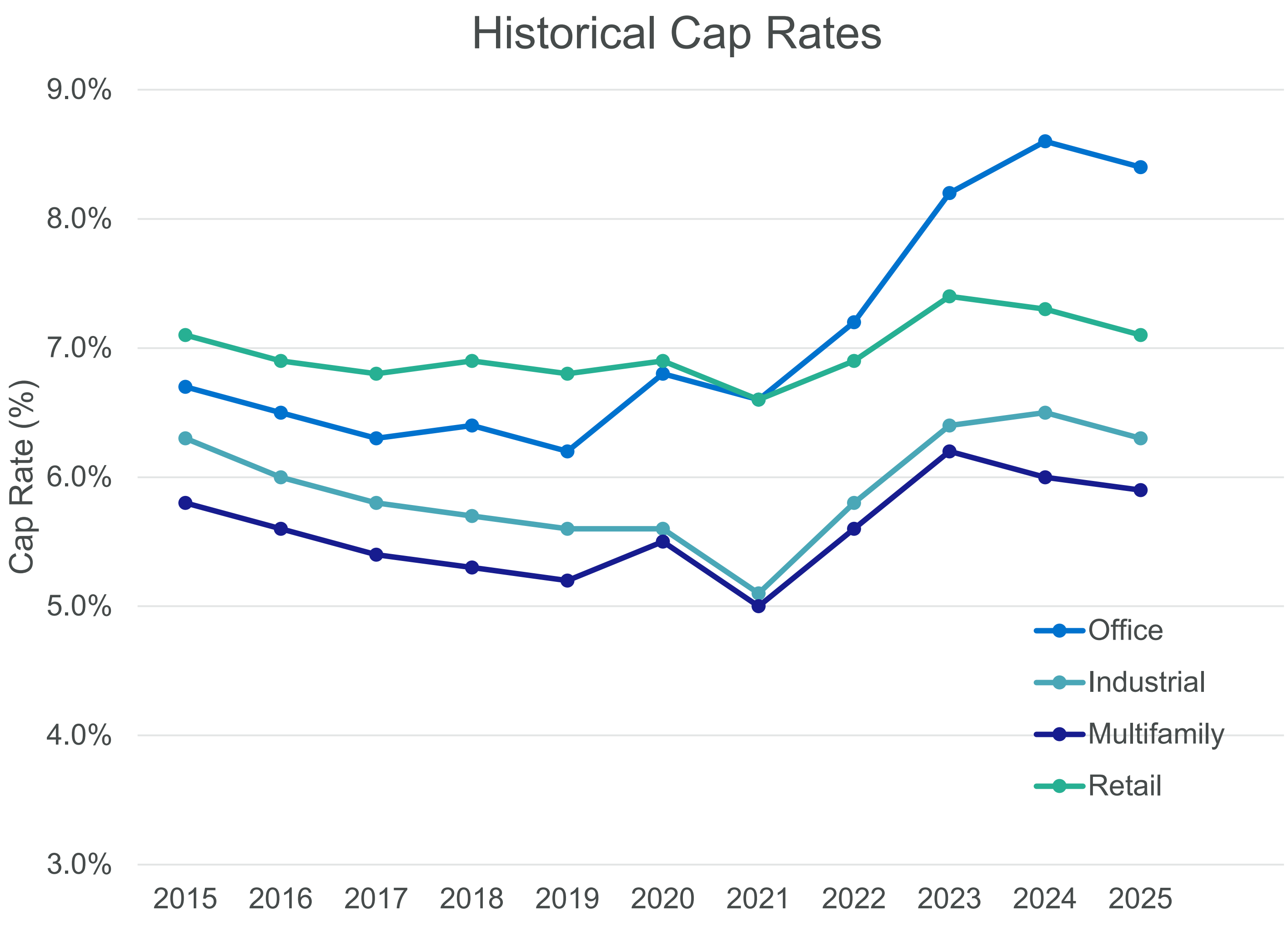
A Bifurcated Market …

Office vacancy up +60% over past 5 years & other sectors up, but within moderate ranges

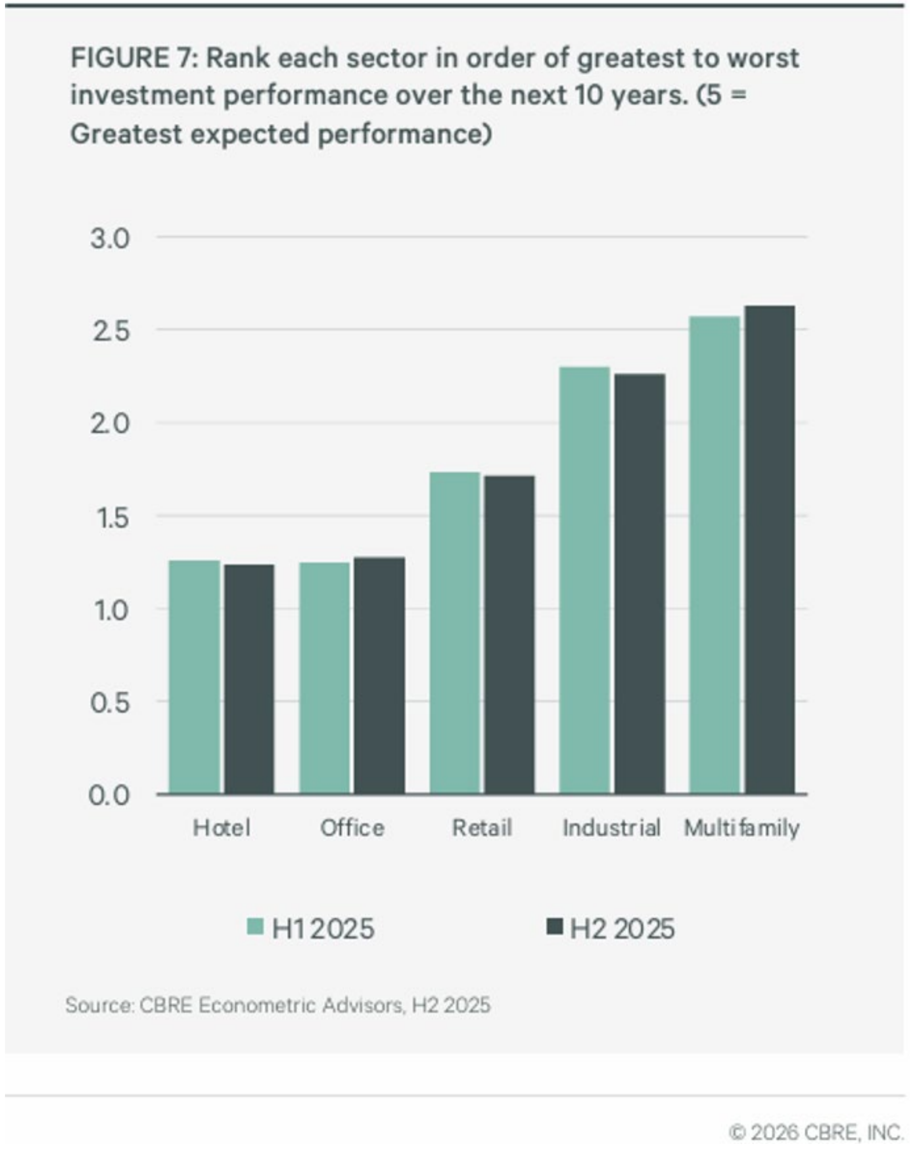
Sector	2020	2021	2022	2023	2024	2025
Office	13.0%	15.5%	17.2%	18.5%	19.8%	20.8%
Industrial	5.0%	5.2%	5.5%	5.7%	5.9%	6.0%
Warehouse	4.5%	3.6%	2.8%	5.2%	6.5%	7.1%
Retail	7.0%	7.2%	7.5%	7.7%	7.9%	8.0%
Multifamily	6.0%	6.1%	6.2%	6.3%	6.4%	6.5%

Sources: Cushman & Wakefield
National Association of REALTORS Statista

Cap Rate Trends



Sources: CBRE



Cap Rates

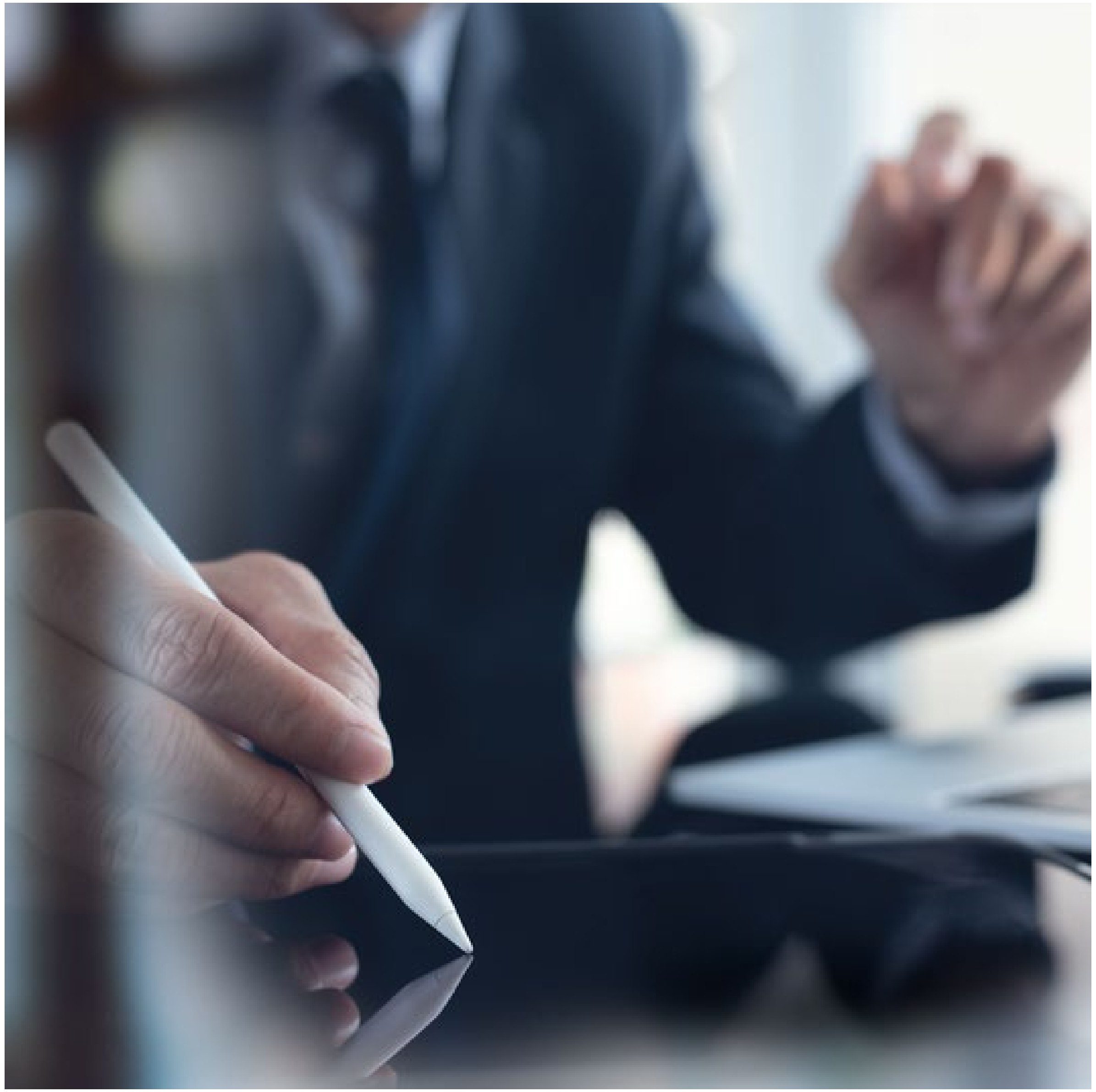
Impact of Rising Cap Rates

- Rising cap rates lead to softening values ← [sales activity drive cap rates[1]]
- Maturing loans, forced sales or restructures may add stress & upward cap rate pressure
- Example using 5 year note & 25 year repay schedule:
  - Office building with 2021 acquisition funding ($1,250M note amt):
    - U/W $100,000 NOI / 6.0% cap rate = FMV of $1,667M, advance rate **75%**
    - 8.1% cap rate at 2026 maturity = EV $1,235M vs. amortized balance $1,093M → **89%** LTV
    - → 26% reduction in value & non-conforming LTV limit rewrite / refi out options

[1]capitalization rate % formula = property NOI / MV x 100

scenario A: property ABC's NOI is $100,000 / Purch Price is $2,000,000 → cap rate = **5.0%**

scenario B: property ABC's NOI is $100,000 / Purch Price is $1,400,000 → cap rate = **7.1%**



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Property Expenses
Rising Operating Costs

Property costs are ↑ 20% to 35% over the past 5 years

The Drivers:

- property insurance
- property taxes
- repairs + maintenance
- labor + building services
- utilities

Weakened demand for sectors like Office limits ability to recapture expense increases

…but not just office: “operating expense inflation is evident in virtually every CRE asset class since 2020” (AFIRE 2026)

Value impact is direct with reduction in NOI due to uncaptured expense increases

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CRE AQ Summary

Bifurcated Asset Class With Divergent Credit Quality Per:

- sector
- class
- region
- location (CBD vs. suburban)
- local politics

Takeaways:

- leverage matters
- extend & pretend is not a strategy
- liquidity matters
- TLMs: 1st loss is your best loss
- sponsors (good ones) make a difference
- recourse is still important within the realm of community banking
- structure matters

Problem Loans

Emphasizing the Primary Source of Repayment

The Rise of Special Mention & Substandard

A Special Mention asset has **potential weaknesses that deserve management's close attention**. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified

A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have **a well-defined weakness or weaknesses** that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Common Red Flags

Delayed or incomplete financial statements	Avoidance of communication or specific questions	High turnover in key personnel	Unusual or suspect asset sales
Habitually late or partial payments	Non-payment of taxes (payroll, sales, property)	Declining credit scores & excessive inquiries	Loan covenant violations
Cash flow shortfalls	ISFs + poor deposit acct behavior	Requests for add’l WC funding	Static BS accts including A/R & inventory

Potential Indicators of Emerging Problems: CRE

Real Estate

- Actual NOI below appraisal NOI
- Upcoming maturity/ reprice? Can actual NOI support the increased rate?
- Upcoming lease expirations?
- If older appraisal with low cap rate, recalculate value based on current NOI and updated cap rate
- Past due real estate taxes

Multi-Family Real Estate

- Occupancy declining
- Rental rates lower than projections/ appraisal
- Underfunded reserves
- Deferred maintenance

Potential Indicators of Emerging Problems: Specialty

Hospitality

- Hotel metrics below comp set- STR Reports
  - Occupancy
  - Average Daily Rate
  - Revenue per Available Room
- Inadequate reserve for required property improvement plan (PIP)

Agriculture

- Actual yield & prices below projections
- Weakening working capital
- Leveraged balance sheet
- Increasing input expenses

Potential Indicators of Emerging Problems: Other CRE

Assisted Living / Skilled Nursing

- Low or declining occupancy
- Higher expenses (specifically labor)
- Delayed/ reducing government insurance reimbursements

Construction

- Depleted interest reserve
- Change orders
- Delays or cost-overruns
- Limited construction tracking
- Interest rate increases since origination
- Updated valuation’s NOI does not cover scheduled P&I payments

Potential Indicators of Emerging Problems: Non-CRE

C&I

- Collecting A/R faster
- Stretching A/P
- Increased accrued expenses
- Declining working capital
- Increasing D/NW
- Increasing expenses compared to sales
- Borrowing base is tightening or out of trust
- Makeup of the borrowing base is changing
- Line of credit not resting (when expected)
- Excessive distributions

Collateral Integrity

- Borrowing Base Certificates
- A/R by due date instead of invoice date
- BBC is not calculating ineligible receivables, tainted receivables, etc. correctly or at all
- BBC values do not reconcile with the applicable financial statement
- Floorplan inspections
- Showing vehicles not paid off timely
- Curtailments not being made as required

Not excluding ineligible collateral

- government receivables
- foreign receivables
- affiliate transactions

Not excluding tainted receivables

- if a customer has more than a predetermined % of its total A/R balance > 90 days, the remaining balance should also be ineligible

Aging A/R by Due Date

- aging by invoice date is prudent practice

Accounts Receivable Missteps

(what not to do)

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Trend Analysis

An Important Credit Risk Management Tool

Trends may be just as important as actual financial results

Help assess a borrower's financial health (trajectory) over time

Reveal patterns in revenue, expenses & profitability

Reveal potential risks or red flags in financial behavior

Support informed credit decisions & proactive risk management

Enhances a lender's ability to forecast future performance

Balance Sheet Shifts Signaling Risk

Declining Working Capital

tightening liquidity

increasing reliance on debt to fund operations (your LOC?)

Increasing A/R

slower collections and/or deteriorating customer credit quality may lead to future cash flow issues

Rising Inventory Levels

overproduction, declining sales, obsolete stock tie up cash & signal inefficiency

Expanding Short Term Debt

reliance on ST borrowings to maintain operations w/o top line growth will increase refinancing risk & interest burden

More Balance Sheet Factors That Imply Risk

Declining Equity

may reflect losses, dividend over-distribution / lack of reinvestment

↓

weakens capital base

Asset Sales or Revaluation

asset sales may prop up cash flow temporarily

revaluations can mask underlying performance issues

Off-Balance Sheet Liabilities

leases, guarantees or other contingent liabilities may not be readily visible but can contribute to risk

Additional Concerning Financial Statement Trends

Unusual or Non-Recurring Items

large one-time gains / losses can distort earnings & mask underlying issues

Rapid Asset Growth w/o Revenue Growth

may indicate overexpansion, poor investment decisions, or inflated asset values

Deferred Revenue or Expenses Increasing

may suggest revenue recognition issues (billings in excess of costs) or delayed expense reporting (i.e., acctg/bookkeeping issues)

Intangibles growing faster than Tangibles

may indicate an inordinate concentration in goodwill or intellectual property which - & both may be harder to value

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Problem Loans
How is the borrower paying?

A problem loan is a problem regardless of the risk grade assigned by the CU or Bank.

- via refinancings / increased debt
- you see owner's injected capital or $ loaned to the company
- not paying property taxes or utilities
- not submitting payroll taxes withheld from employee comp
- relying on non-formula based LOC borrowings
- shrinking a company frees up cash, especially if lender's debt is not reduced in proportionately

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Response

What Now?

Problem Loan Management

1. **Recognize** potential problems early
2. **Downgrade** rating timely
3. **Identify** the root cause (operational, financial, external, etc.)
4. **Verify** collateral position & condition via: property inspection/ updated, appraisal, field audit or exam
5. **Add** collateral, guarantor, or co-borrower & interest/ payment reserve
6. **Restructure** as appropriate; legal support; forbear & reserve rights; tools: I/O payments, reamortize, duration & performance
7. **Implement** action plan w/ triggers (more than monitor for payments, review FSs, etc.)
8. **Write-down** as required (1st loss is best loss)

Forbearance Agreement

Leverage a default or other bad behavior to regain control & establish a prudent course

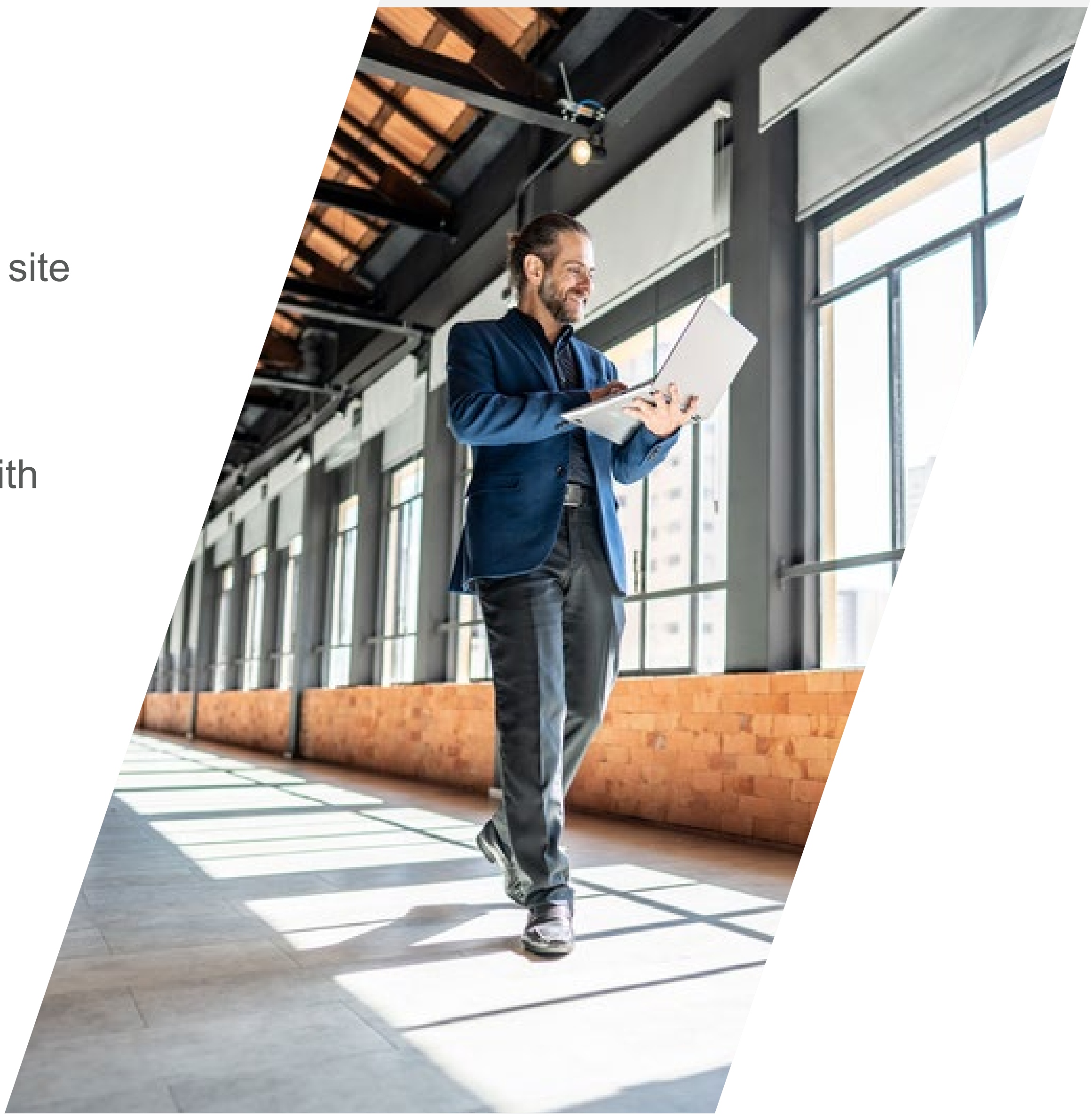
- Formalizes borrower's obligations
- Establishes timeline for progress
- Facilitates a path to performing status, payoff or orderly exit
- Provides interim relief in exchange for good behavior / credit enhancement
- Preserves lender's rights

Case Studies

Case Study #1

“The GC”

- Borrower engaged in construction, renovation, steel erection & site utilities business
- New customer to the financial institution/lender
- New loan: $7 million LOC to replace LOC at the prior lender, with add’l availability to take advantage of AP discounts
- Line fully funded day #1



Case Study #1 – Continued

Lender Perspective

- LOC underwriting analyzed 2 years of reviewed financial statements & an interim FS
- Borrower financials depicted satisfactory profits & cash flow support
- The lender documented improved working capital & leverage

Case Study #1 – Continued

Our Perspective

The lender missed several red flags in the balance sheet

- Revenue grew by 70%, but A/R increased by 82%
- A/R turn increased from 119 to 167 days
- Costs in excess-of-billings rose 135%
- Taxes payable increased by 256%

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Case Study #1 – Conclusion

- Several large receivables were in litigation
- Lender did not complete a field audit prior to loan origination & not before fully advancing the line
- Borrower had not been paying payroll taxes- they owed the IRS $1.3 million a few months after loan origination
- The $7 million line was fully funded, borrowing base was out of trust by nearly $3 million out of the gate
- Financial institution eventually charged-off $5.5 million

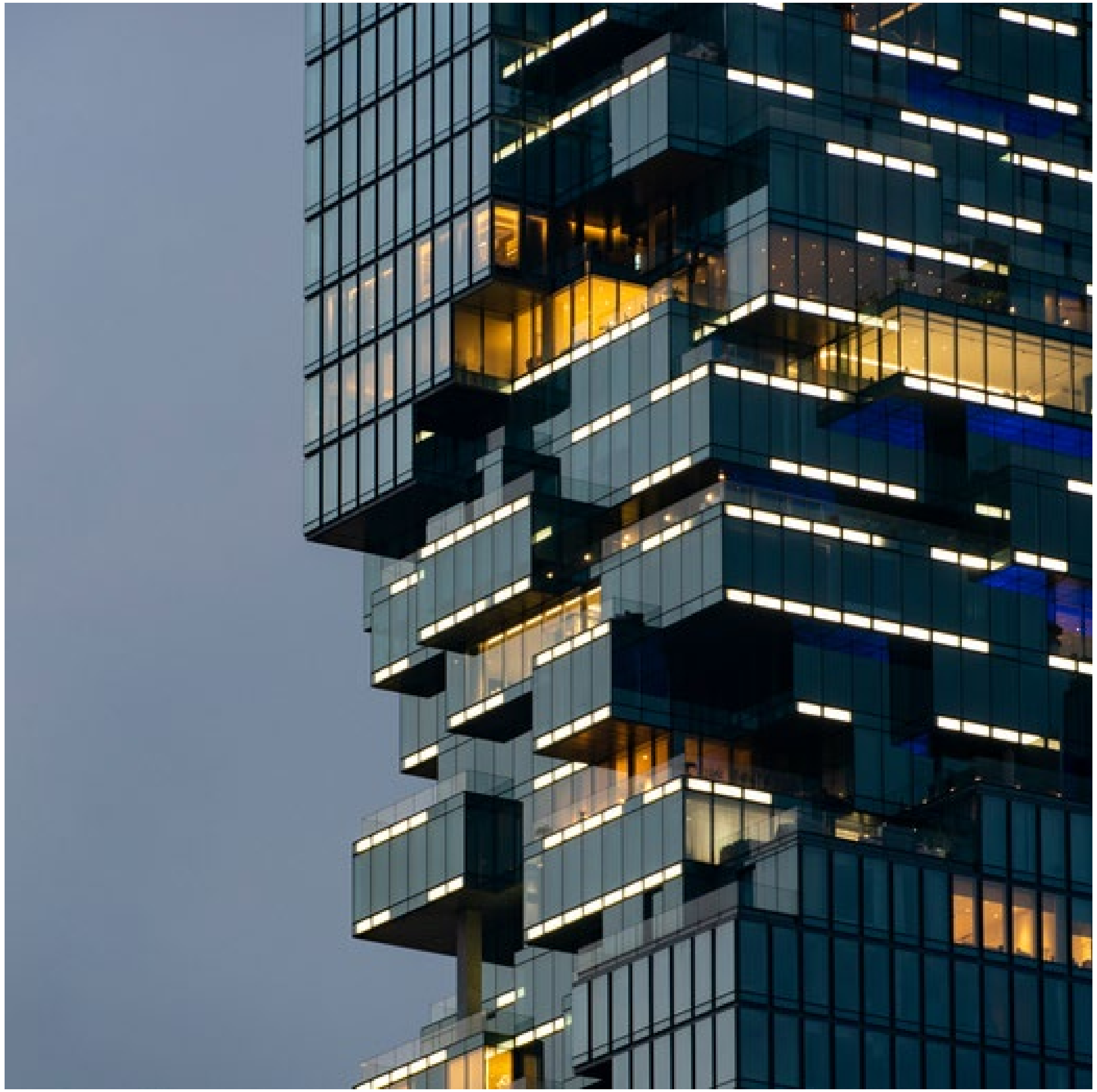
Case Study #2
“The RE investor”

Borrower attributes:

- owner-manager of lower priced rental homes
- realizing rapid growth
- weakening cash flow (co. taxed by fast-pace growth)

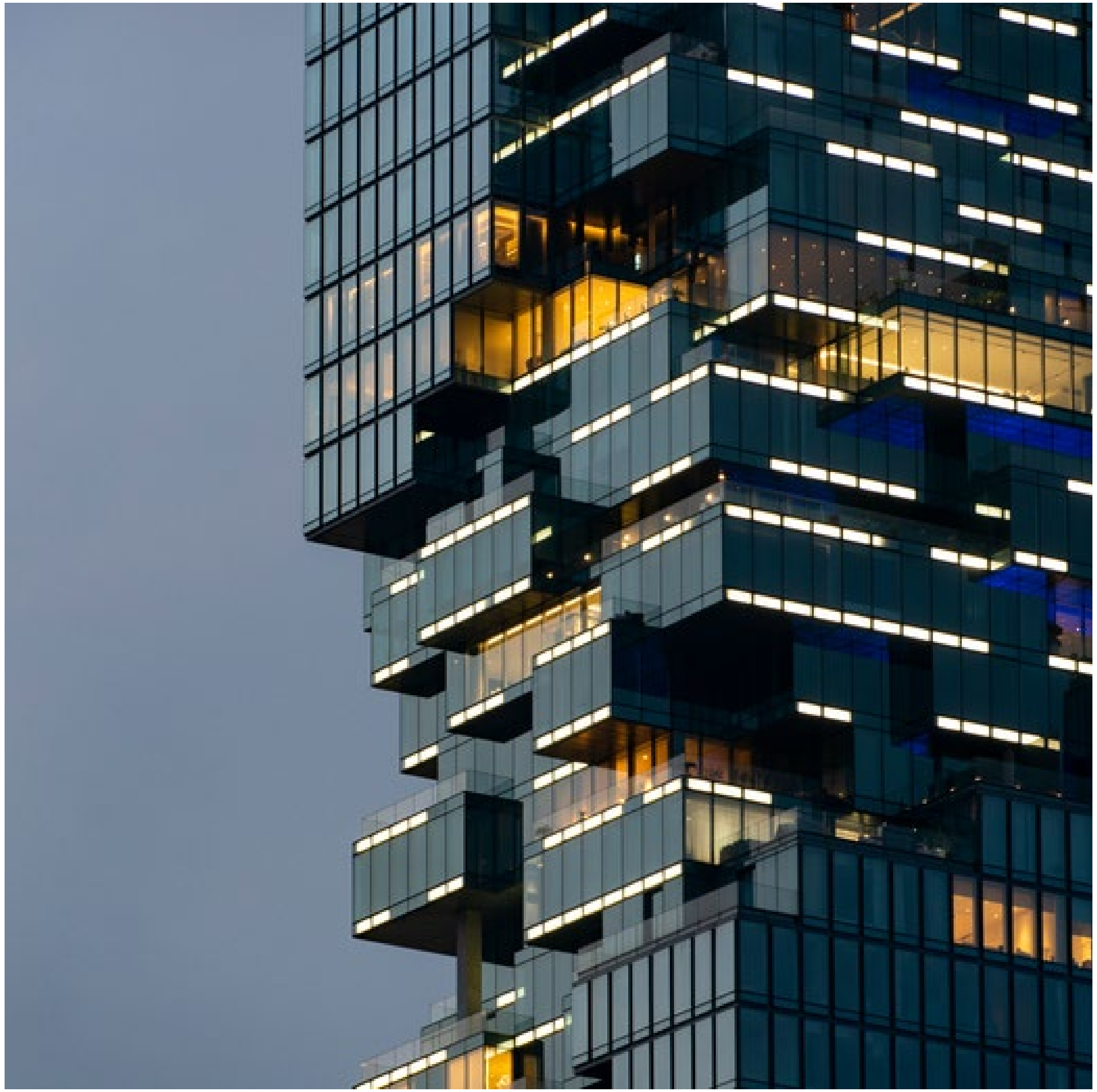
Case Study #2 – Continued

	2021	2022	2023
Available for DS (NOI) (Global)	$861M	$862M	$596M
Estimated Debt Service	$647M	$1,019M	$1,050M
Excess/ Shortfall	$187M	($157M)	($454M)
Debt Coverage Ratio	1.27x	0.85x	0.57x



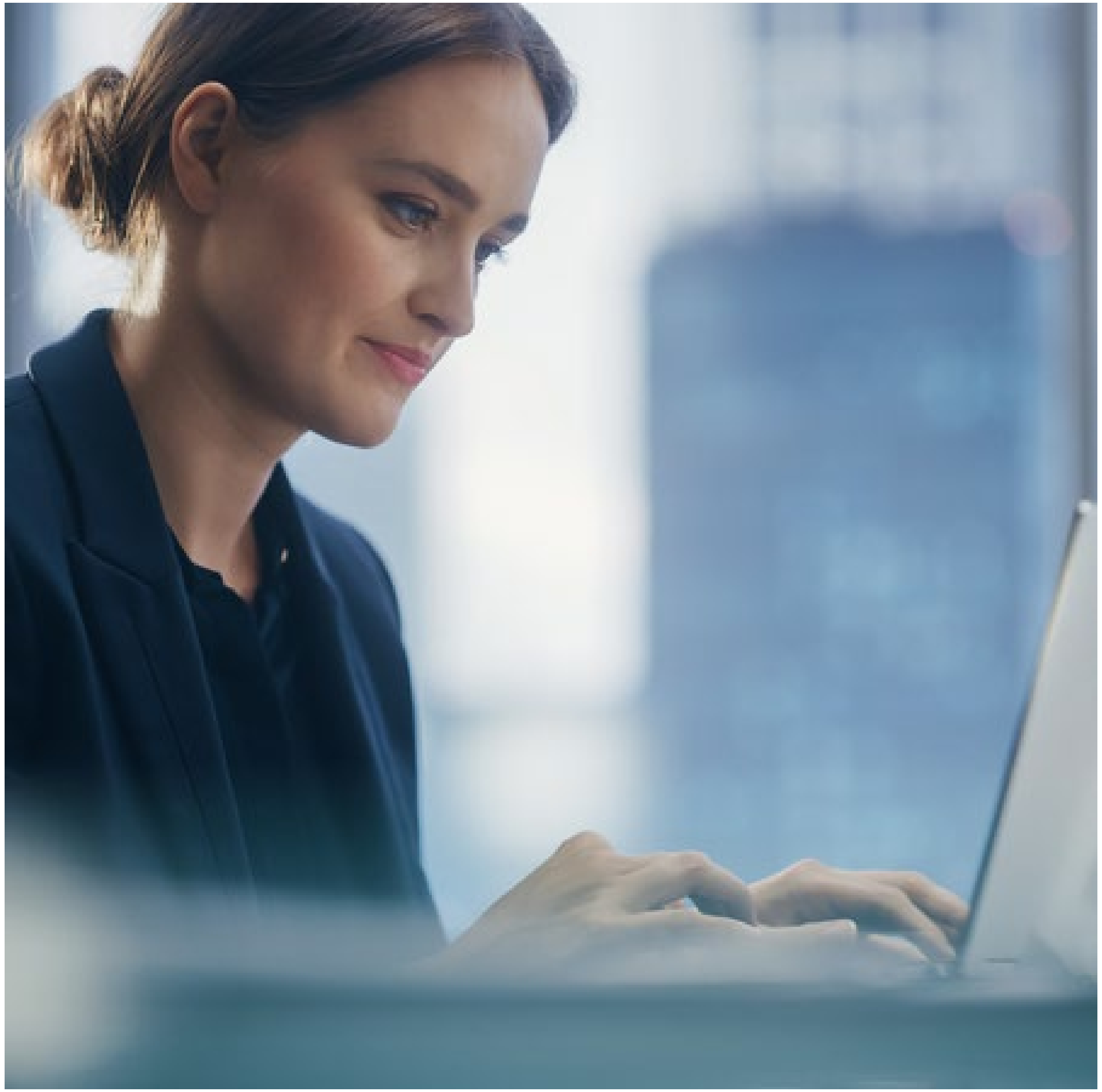
Case Study #2 – Continued

Guarantor's PFS Highlights	Reported Value
Cash	$800M
Real Estate	$22,261M
Total Assets	$27,305M
Mortgage Debt	$17,382M
Net Worth	$9,910M



Case Study #2 – Continued
Lender's Perspective

- Lender analyzed each loan based on projections which showed positive results
- Global cash flow analysis was completed, but discounted the negative result…"He doesn't report all of his income"
- Lender was comforted by the $800M of cash on the PFS & the $9.9MM net worth
- "He always paid as agreed!"



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Case Study #2 – Continued
Questions to Consider

How much NOI should $22MM of real estate produce?

$1.1 million to $1.3 million (5% - 6% Cap Rates)

How short is the cash flow on covering just interest on $17MM in debt?

$680 thousand using current prime rate

What value might an NOI of $596M support?

Maybe $10 million or so, using 6% cap rate

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Case Study #2 – Continued
Therefore …

If cash flow is severely short, and …

If it appears RE values on the PFS should be about $10 million vs. the $22 million reported & mortgages of $17 million

How would you characterize the level of risk in this loan? And what could the lender have done better?

Case Study #2 – Conclusion

Fraud by the borrower

Loss of over 50% of the lender's loan

A loss which could have been avoided with critical thinking & practical skepticism

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