

OKC Lunch & Learn

Hosted by SouthState Bank



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**Commercial Loan Credit &
Pricing Trends
For 3Q 2024**

- Pricing/risk data and risk-adjusted profitability data from Loan Command aggregates for 3Q to date through 8/16/24.
- Commercial real estate sector performance data from CoStar as of 8/16/24.
- C&I /owner-occupied probabilities of default and loss given default based on PayNet (Equifax) model using 2Q data.



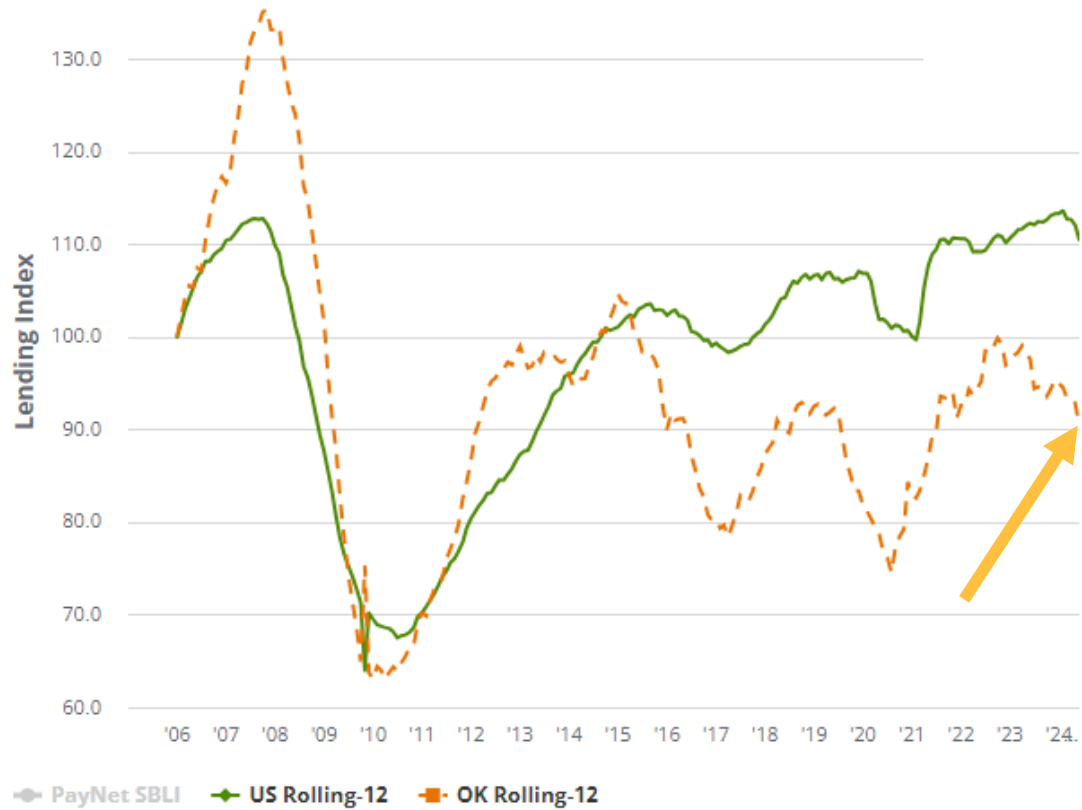


- Push out of recession and rate cuts – focus on inflation
- Slowing pace of Fed balance sheet runoff starting in June
- Office risk rising but could be OK
- Increasing cost of funds & credit risk dropping ROEs
- Investing in America stimulus loan (and deposit production)

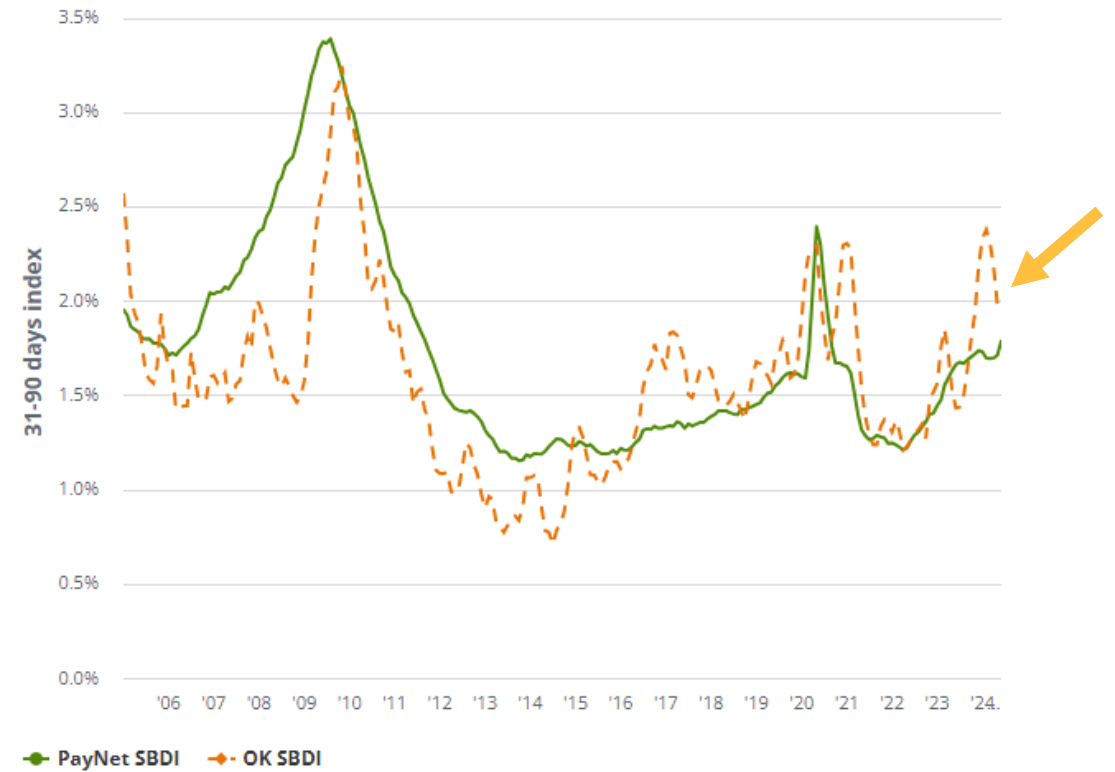
Commercial OK Loan Production



SMB Lending Volume for OK

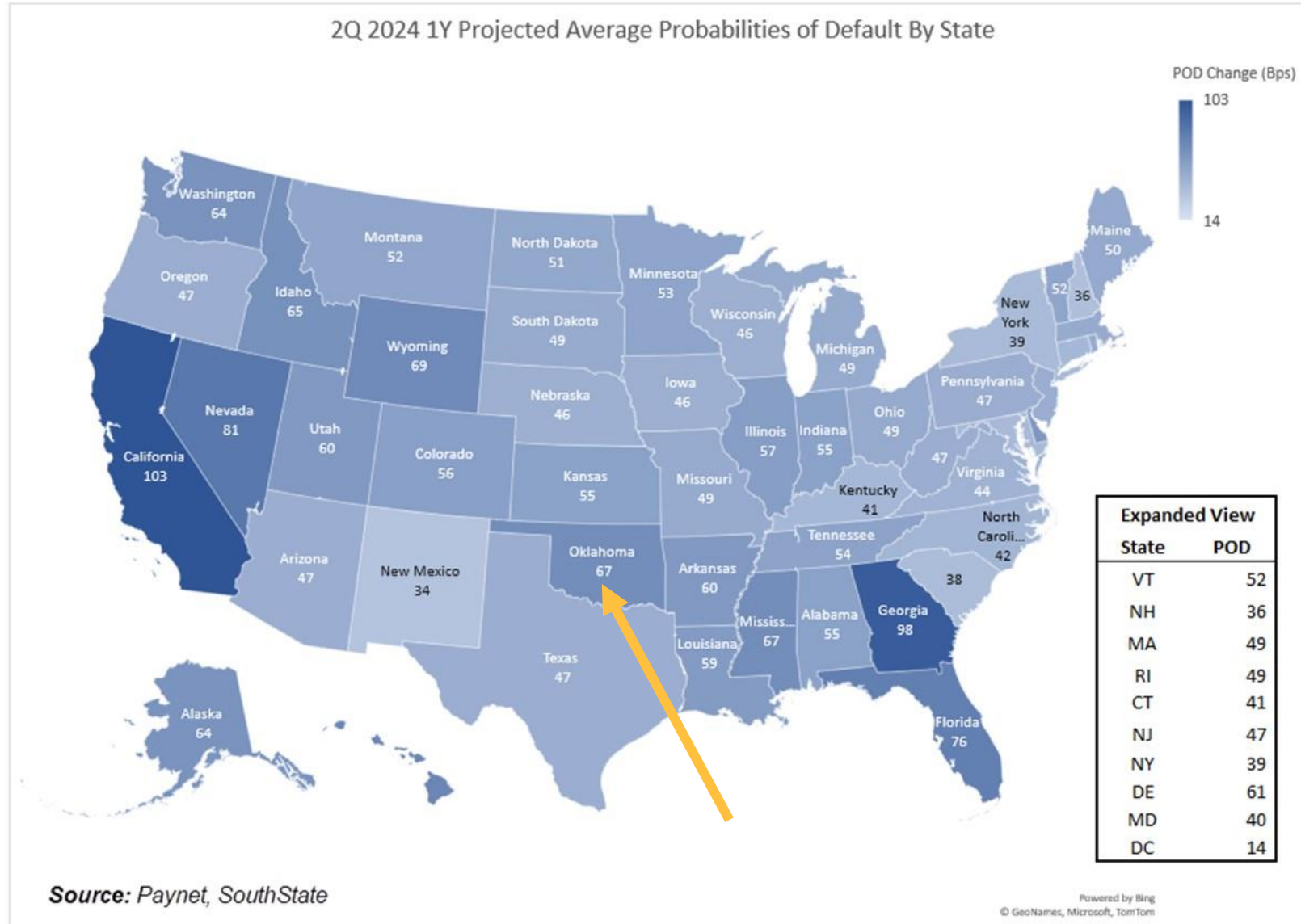


SMB Delinquencies in OK

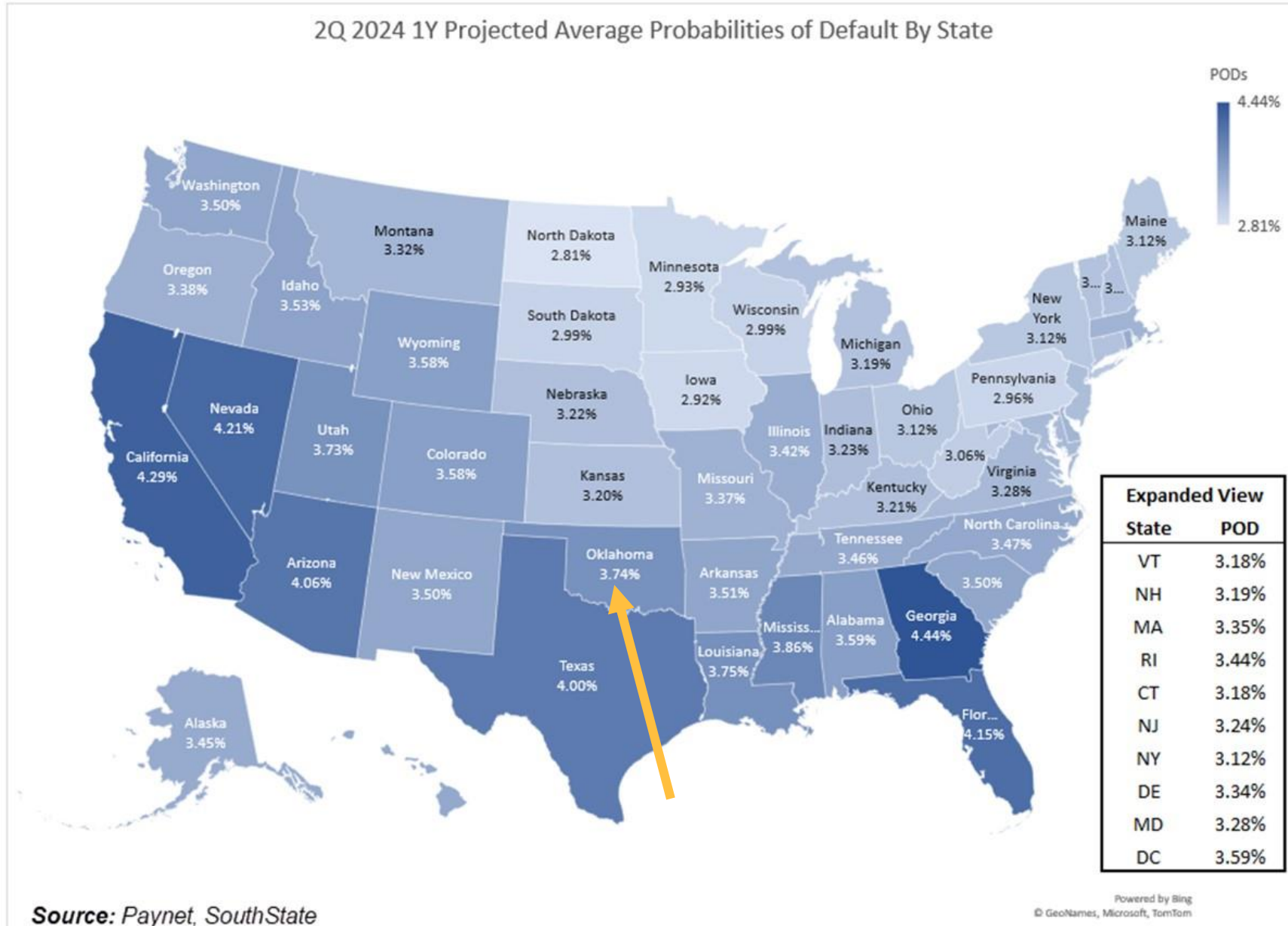


Source: Paynet June 2024

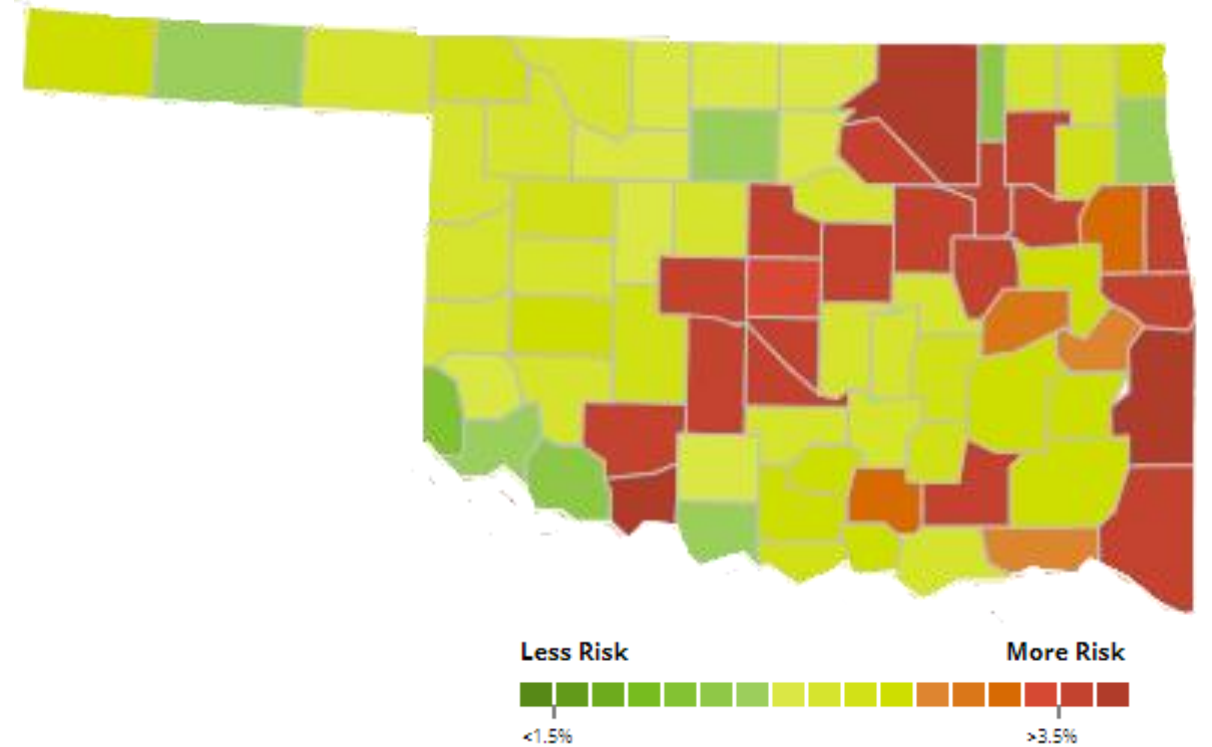
Geographical Credit Change



Geographical Credit Conditions Forecast



Geographical Credit Conditions Forecast



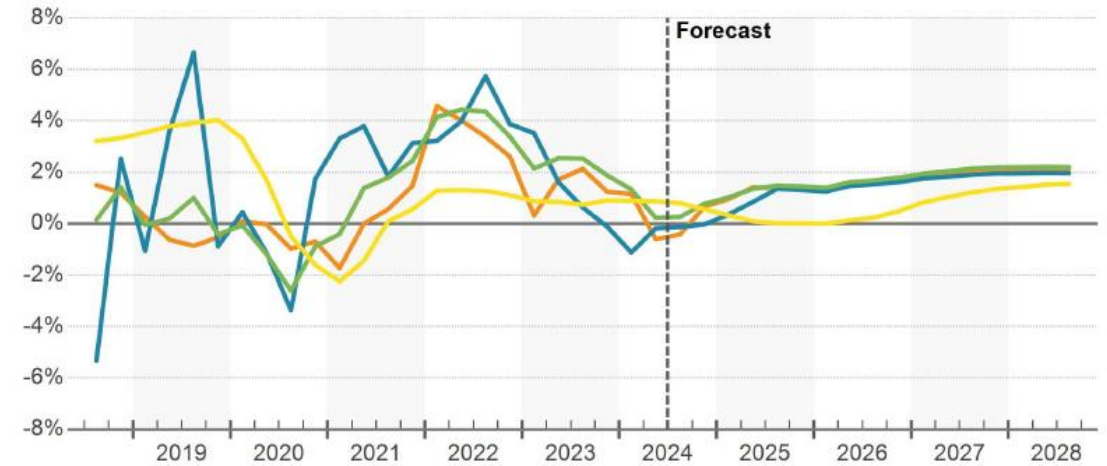
Office



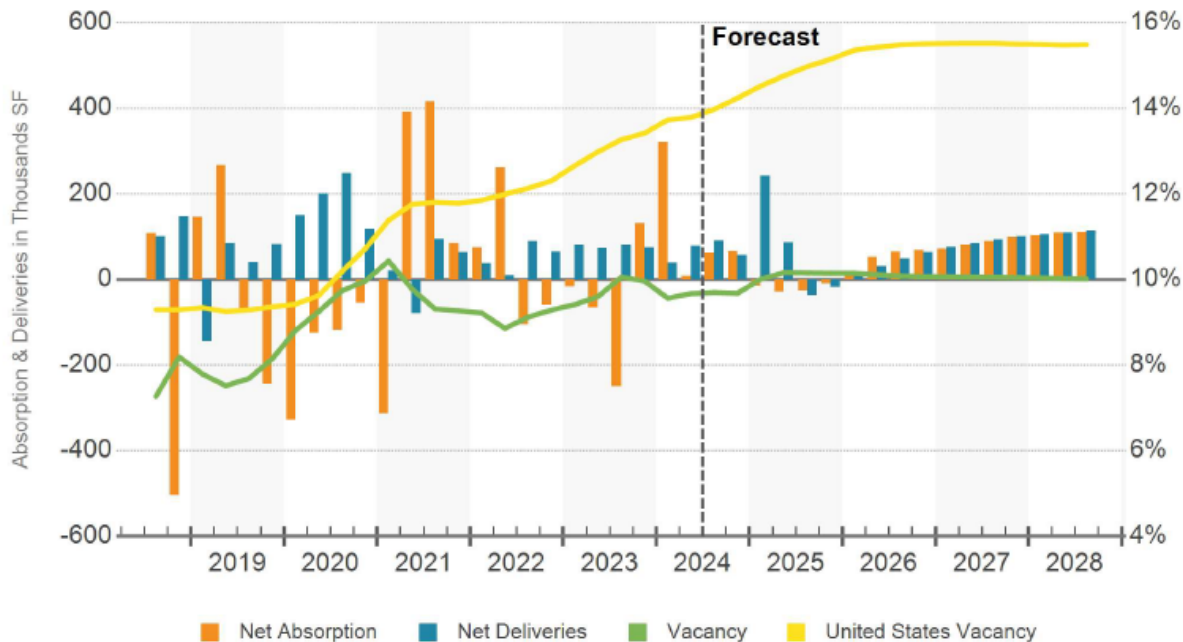
Inconsistent office demand has contributed to expanding vacancy rates over the past 5 years. Large amounts of excess office space continues to leave rent pricing power in the hands of the tenants.

| | Historic | Current | 5Y Forecast |
|--------------|----------|---------|-------------|
| Rent Growth | 2.0% | 0.2% | 1.7% |
| Vacancy Rate | 9.3% | 11.8% | 11.1% |

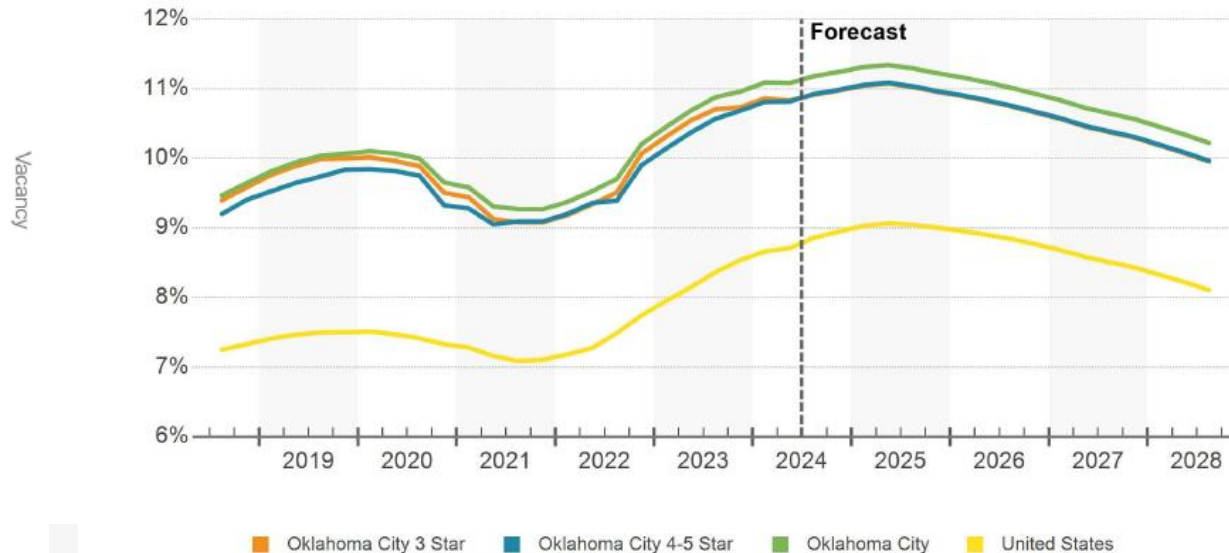
MARKET ASKING RENT GROWTH (YOY)



NET ABSORPTION, NET DELIVERIES & VACANCY



MARKET CAP RATE



- Looking at transit, cell phone and office control data, office usage has stabilized and even improved slightly over last year.
- However, usage is in the 40% to 65% range. Or about 50% of pre-pandemic levels.
- **45% of the office space has yet to come up for renewal**
- Forecasting the “peak day” syndrome
- LTV lower than last recession

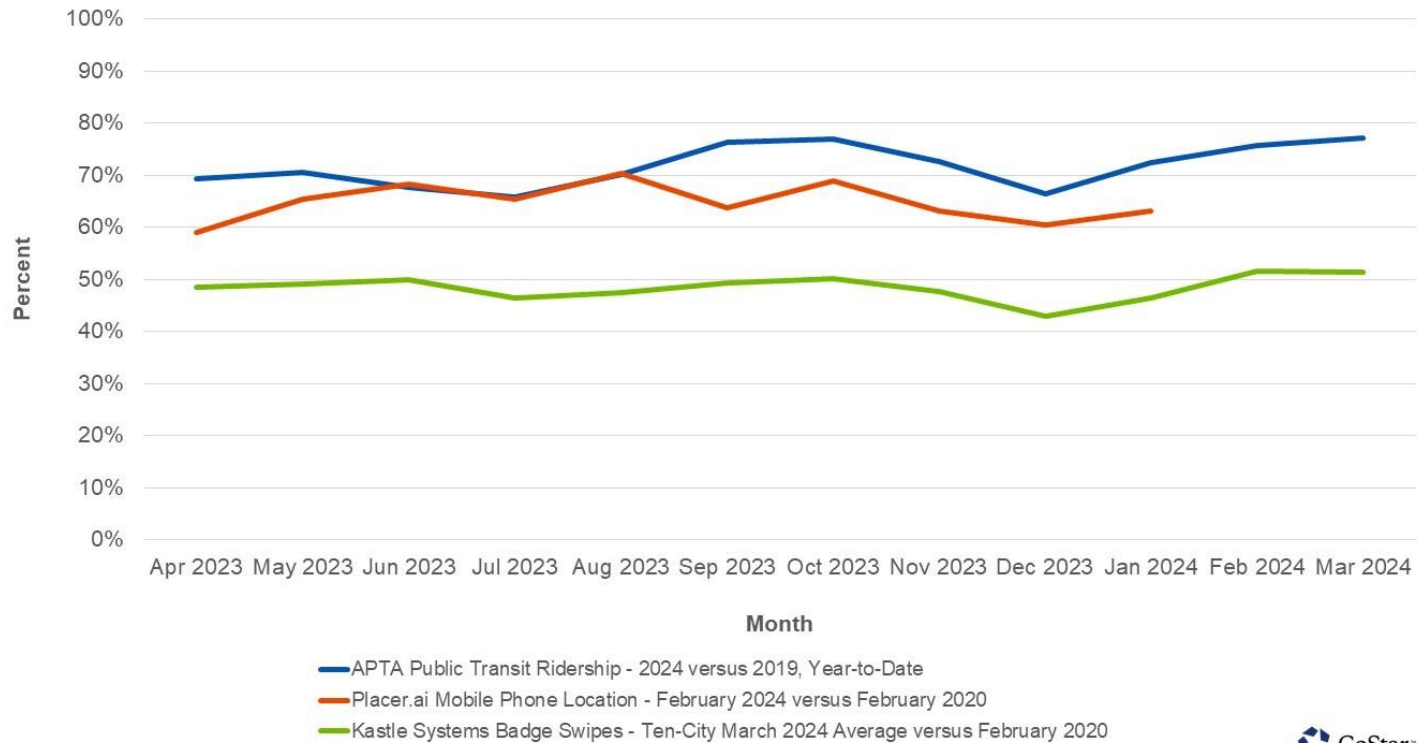


If at risk – Restructure NOW!!!



Office Attendance Stabilizes

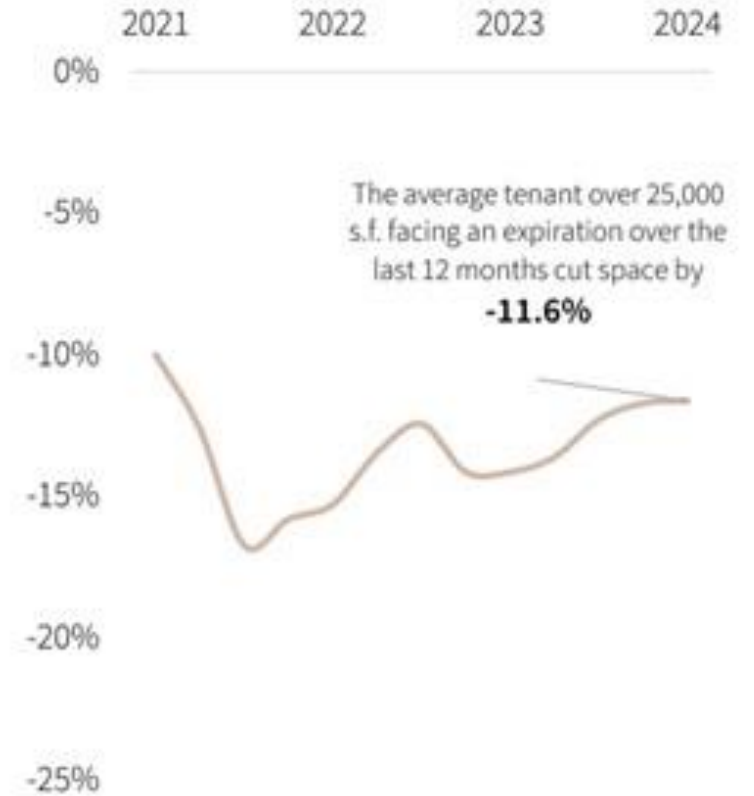
Office Attendance Indicators, 12-Month National Trend



Sources: American Public Transit Association (APTA), Placer.ai, Kastle Systems, May 2024



Downsizing rate for major tenants

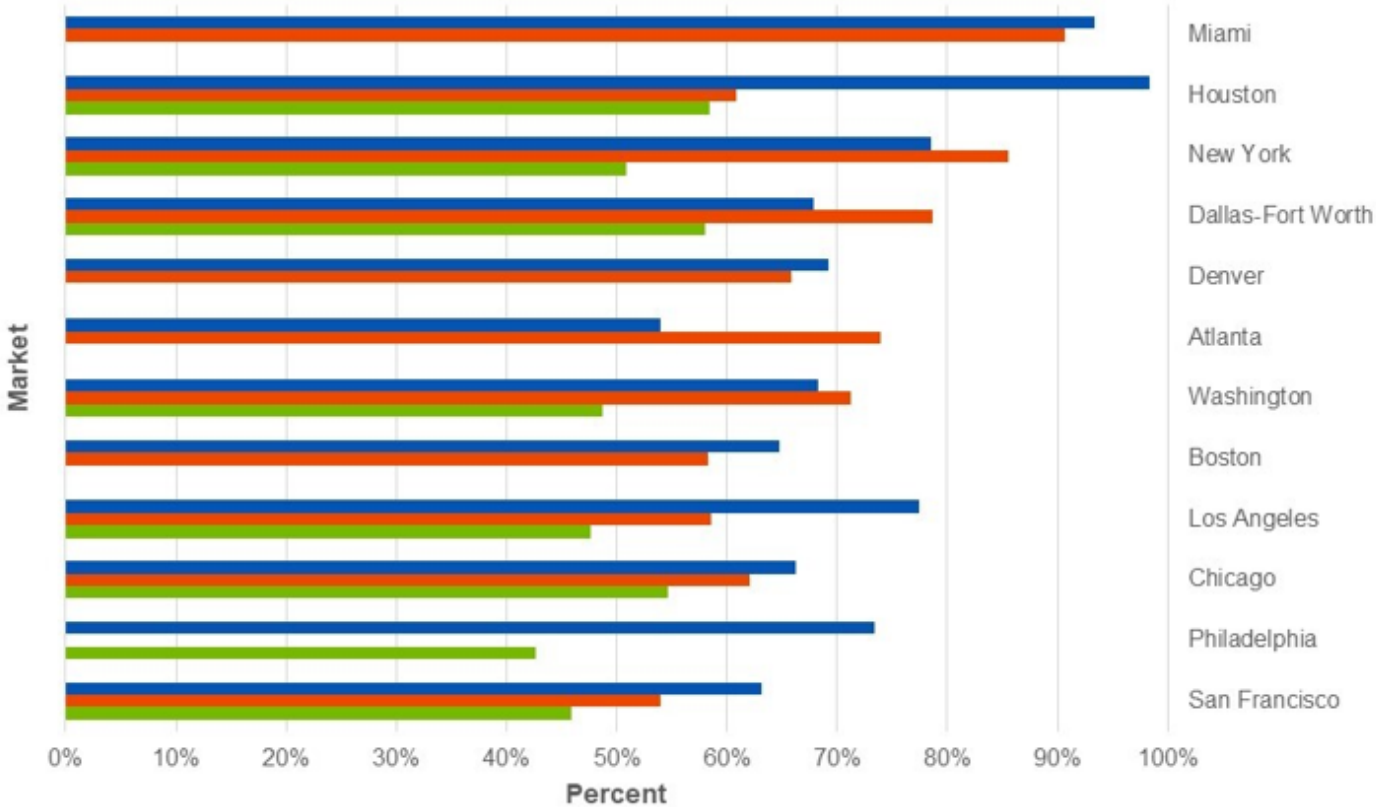


Source: JLL Research

Note: Includes tenants above 25,000 s.f. with a single office location in the market. Excludes tenants who downsized by more than 50% or expanded by more than 50%. N = 1,362

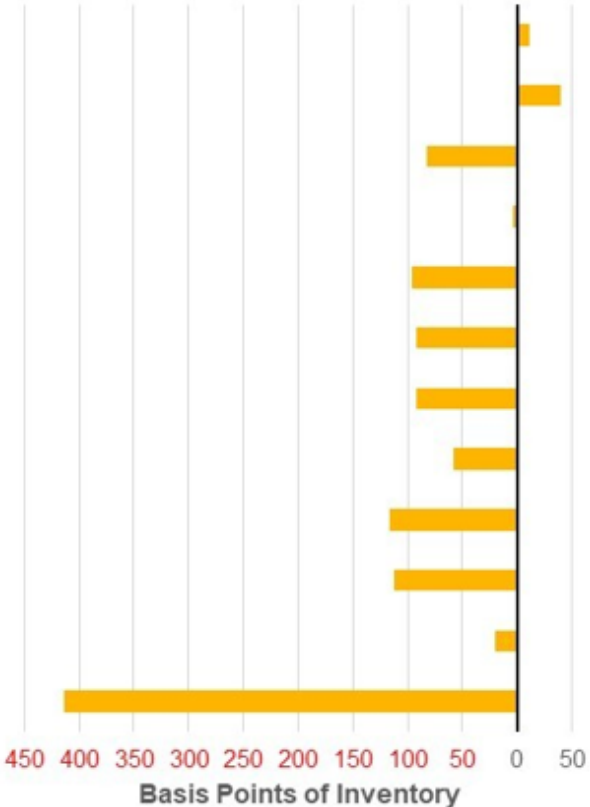


Office Attendance Indicators



- APTA Public Transit Ridership - 2024 versus 2019, Year-to-Date
- Placer.ai Mobile Phone Location - February 2024 versus February 2020
- Kastle Systems Badge Swipes - March 2024 Average versus February 2020

Change in Office Demand, April 2023 to March 2024



- 12-Month Net Absorption



Sources: American Public Transit Association (APTA), Placer.ai, Kastle Systems, CoStar, May 2024

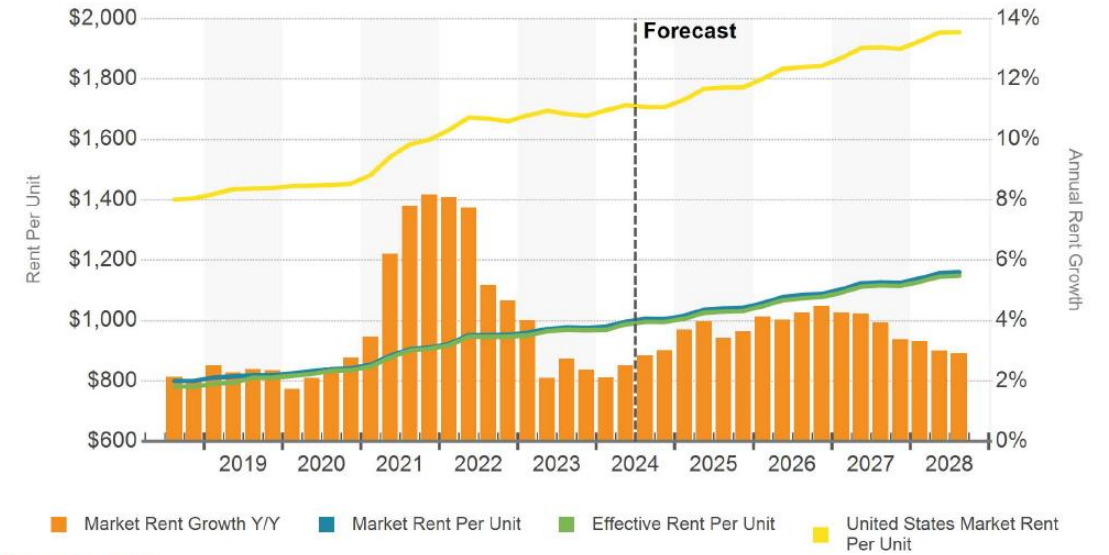
Multi-Family



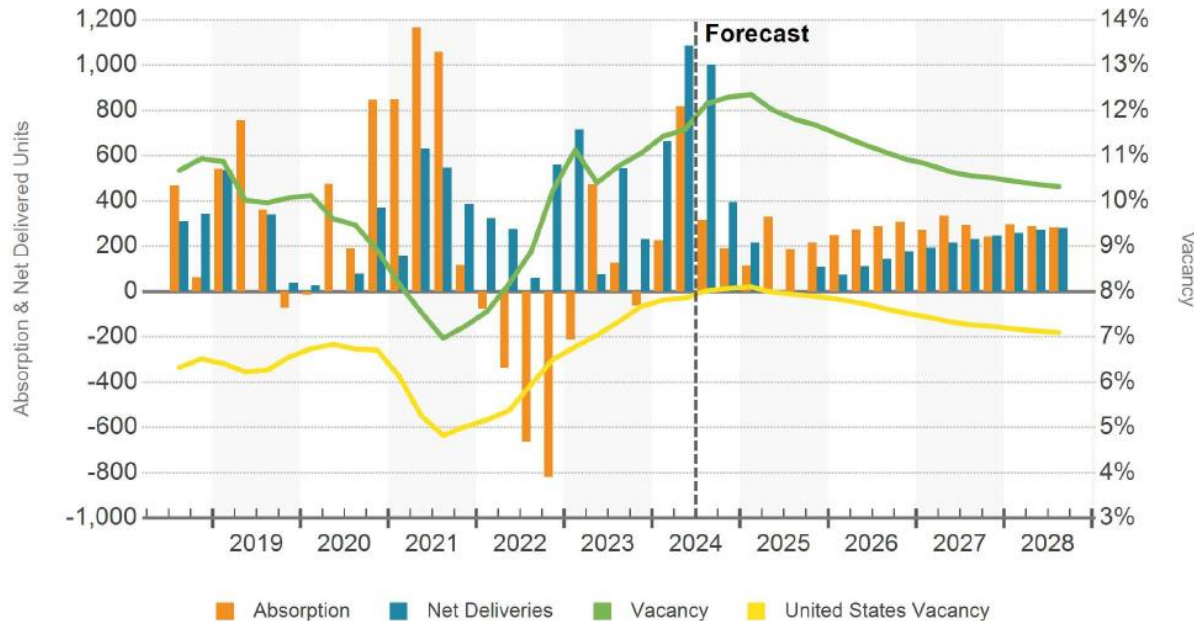
Falling vacancy rates in OK and robust rent growth is showing signs of strengthening demand. There is some cause for concern as this market is correlated cyclically with the dominant energy sector in Oklahoma.

| | Historic | Current | 5Y Forecast |
|--------------|----------|---------|-------------|
| Rent Growth | 2.2% | 3.0% | 3.6% |
| Vacancy Rate | 9.3% | 11.8% | 11.1% |

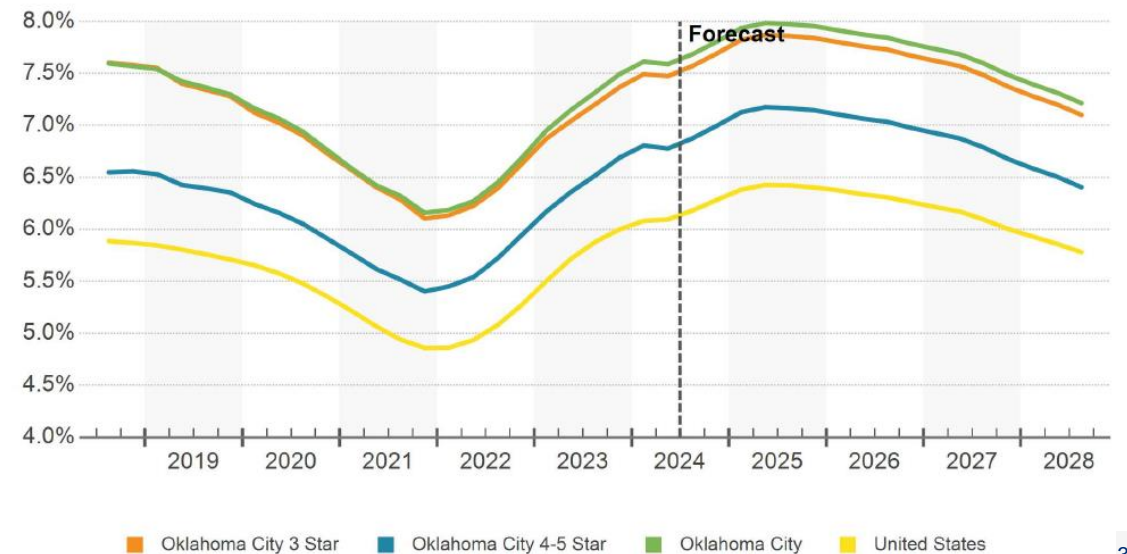
MARKET RENT PER UNIT & RENT GROWTH



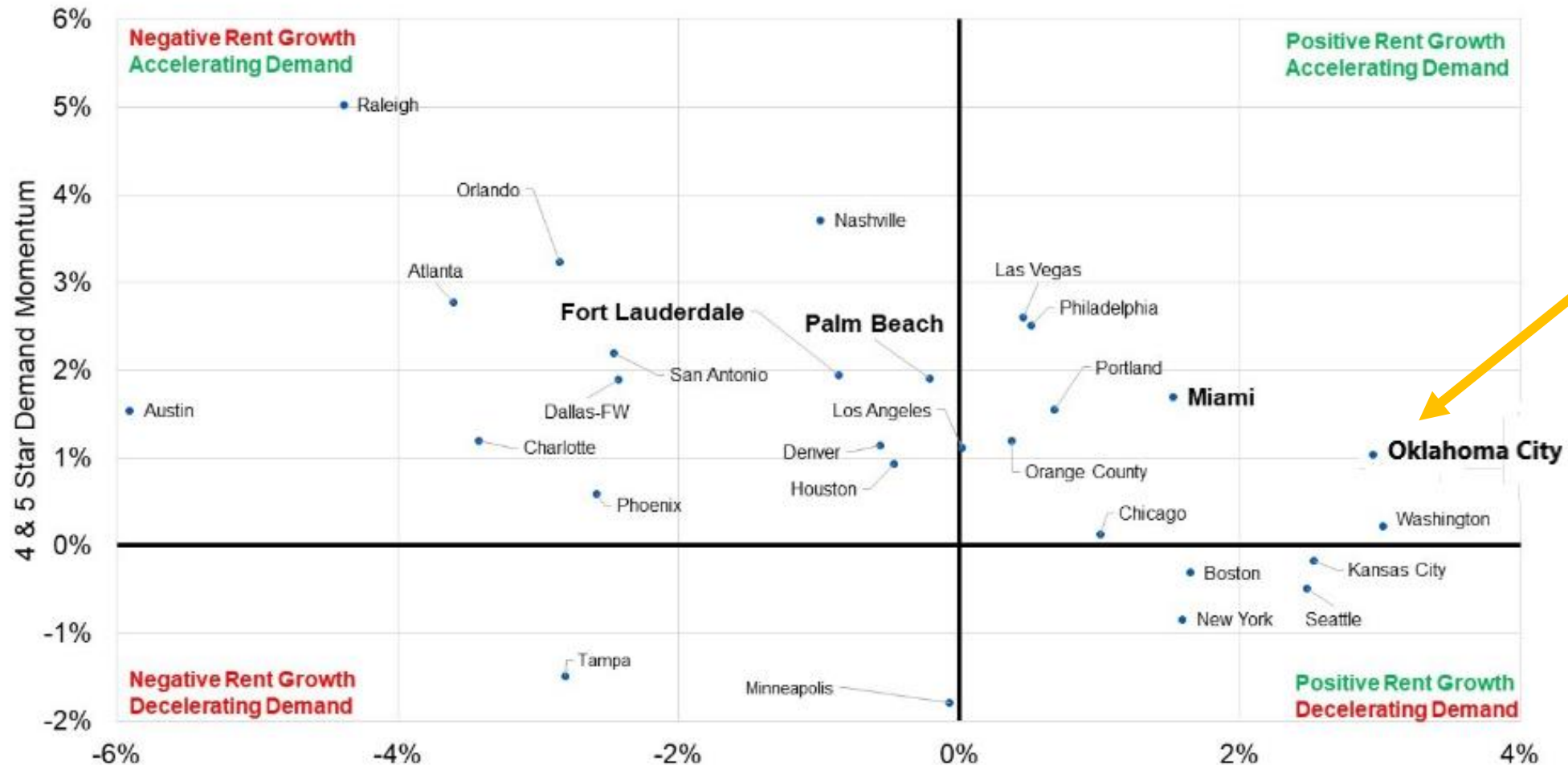
ABSORPTION, NET DELIVERIES & VACANCY



MARKET CAP RATE



Multifamily Rent Growth and Demand



4 & 5 Star Annual Effective Rent Growth, Q2 2024

Source: CoStar, As of June 2024

Note: Demand momentum is defined as the change in annual demand growth between Q2 2024 and Q2 2023. The largest 25 multifamily markets are shown along with all South Florida markets.



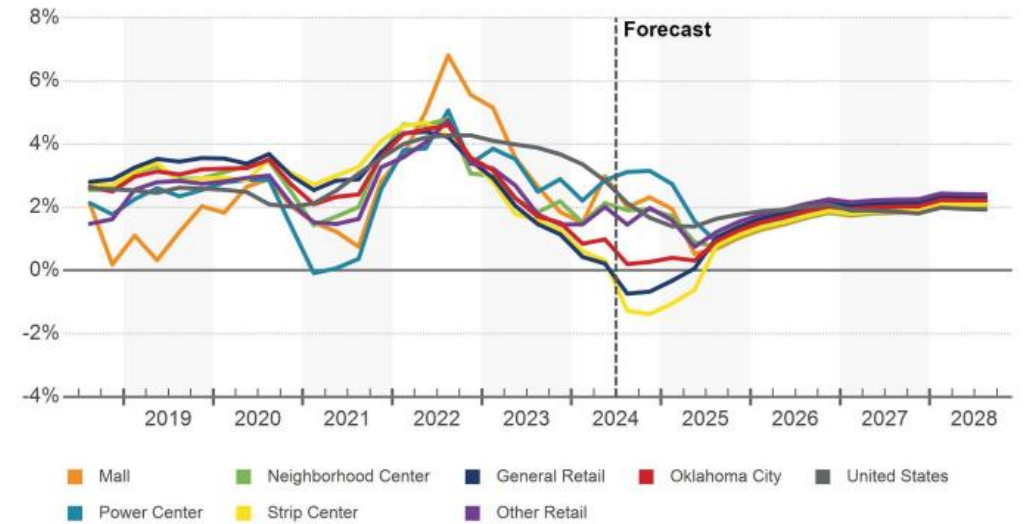
Retail



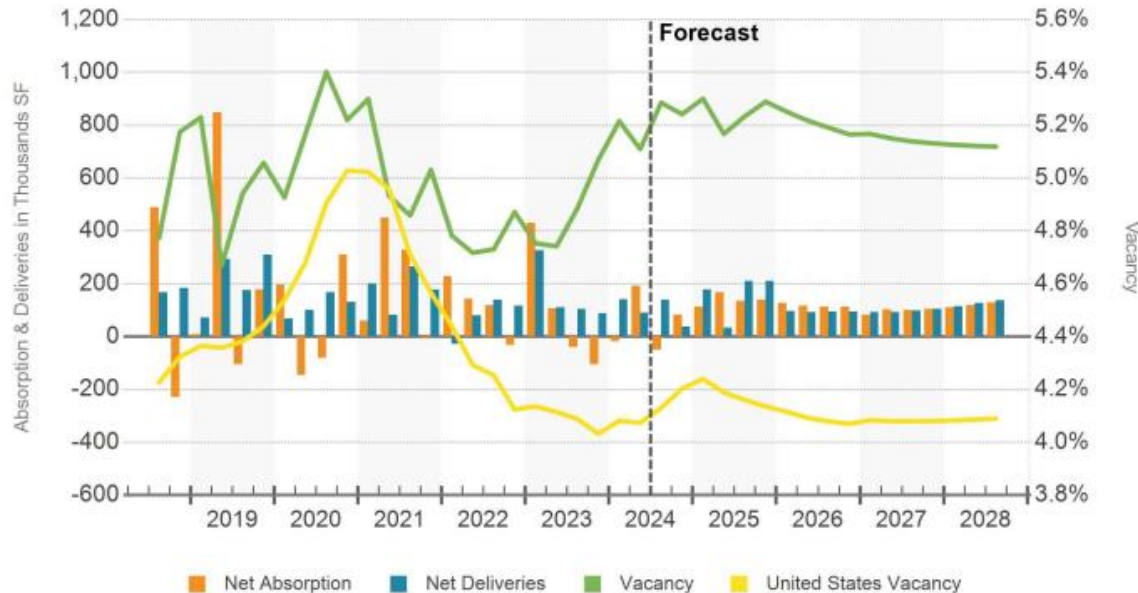
Minimal deliveries and move-outs have kept the Oklahoma City retail market stable. More construction looks to occur in the city as the demographic growth and higher disposable income have encouraged it.

| | Historic | Current | 5Y Forecast |
|--------------|----------|---------|-------------|
| Rent Growth | 2.3% | 0.5% | 1.6% |
| Vacancy Rate | 5.7% | 5.2% | 5.2% |

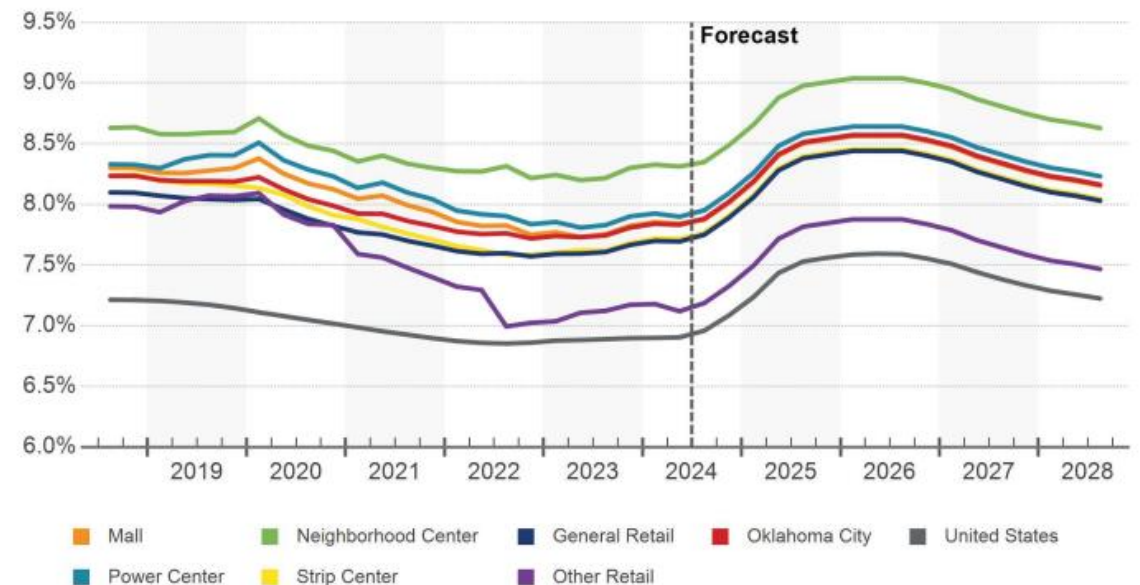
MARKET ASKING RENT GROWTH (YOY)



NET ABSORPTION, NET DELIVERIES & VACANCY



MARKET CAP RATE



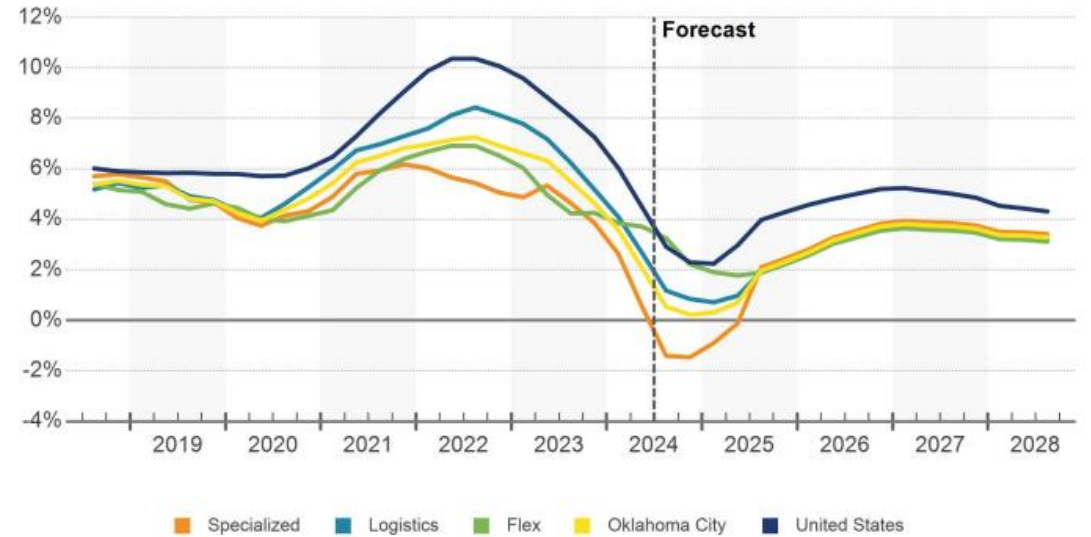
Industrial



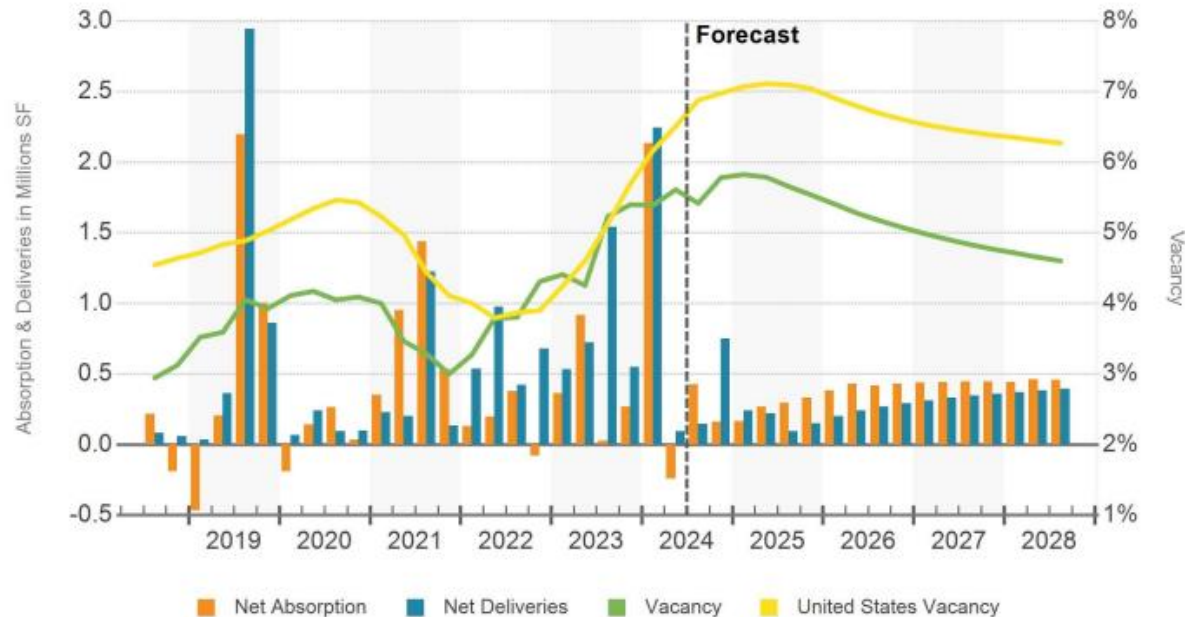
The Oklahoma City industrial market is at a crossroads with project deliveries and large moveouts continuing to hike vacancy rates up. The trends hint at vacancies peaking late in the year with the rent declining as the nation has seen.

| | Historic | Current | 5Y Forecast |
|--------------|----------|---------|-------------|
| Rent Growth | 3.3% | 1.2% | 2.7% |
| Vacancy Rate | 5.0% | 5.4% | 5.1% |

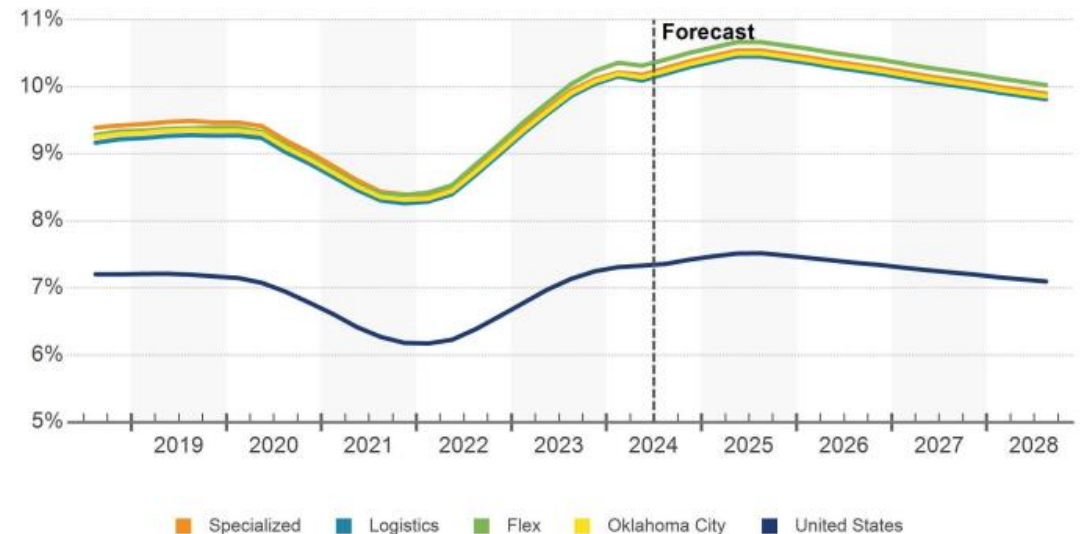
MARKET ASKING RENT GROWTH (YOY)



NET ABSORPTION, NET DELIVERIES & VACANCY



MARKET CAP RATE



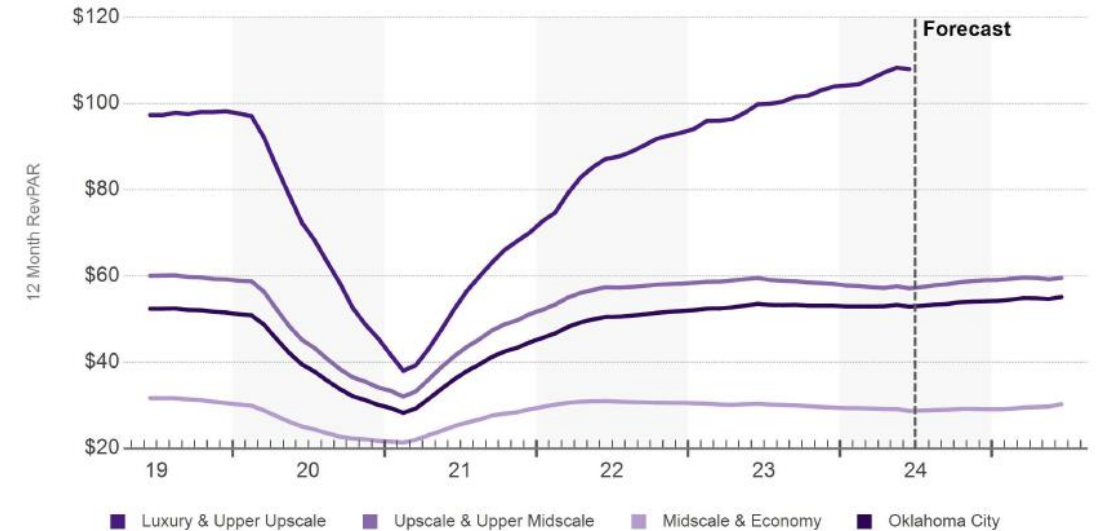
Hospitality



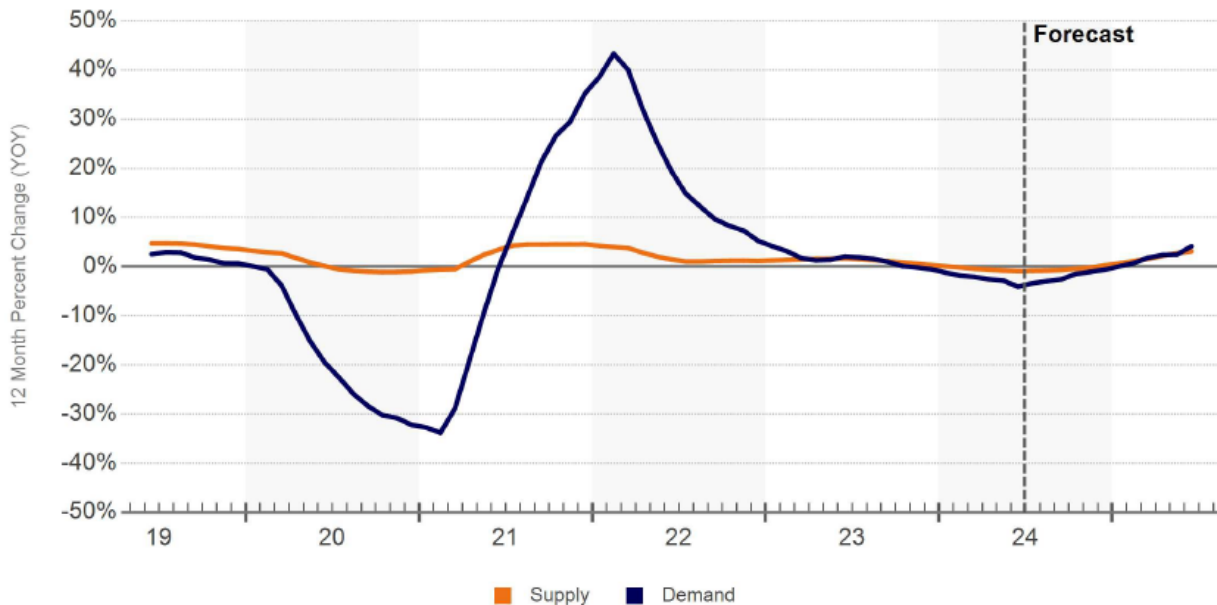
Trailing 12-month occupancy and RevPAR were both down on a year over year basis as of June. Nationally, RevPAR is just into green territory. Inventory continues to expand, with constructions outpacing demolitions.

| | Historic | Current | 5Y Forecast |
|-------------|----------|---------|-------------|
| Occupancy | 53.1% | 60.9% | 56.0% |
| RevPar Chg. | 0.2% | -7.9% | 3.5% |

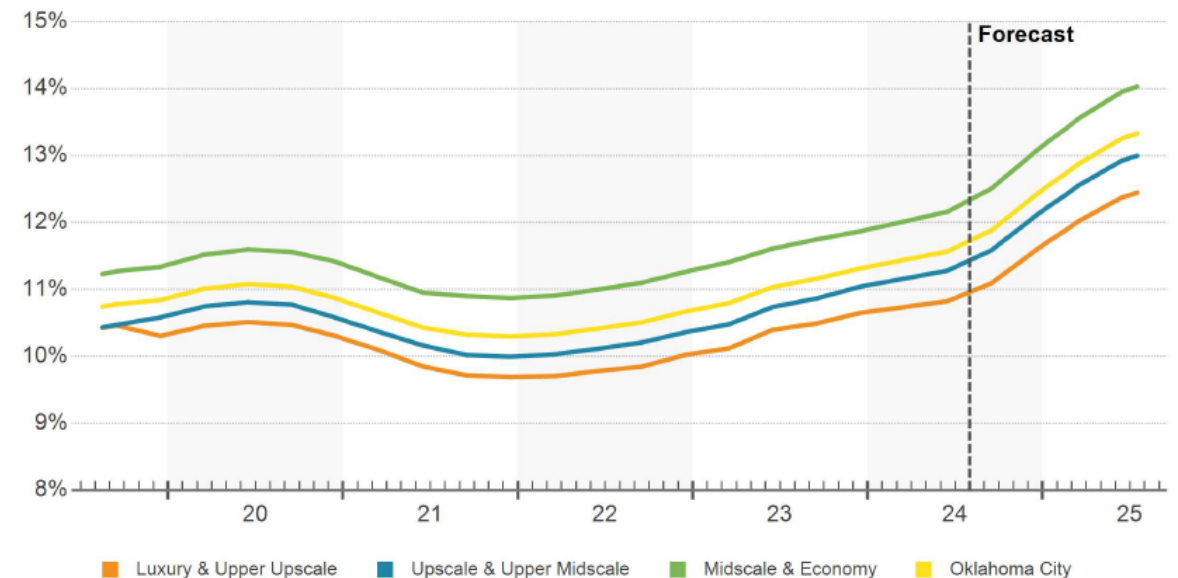
REVPAR BY CLASS



SUPPLY & DEMAND CHANGE



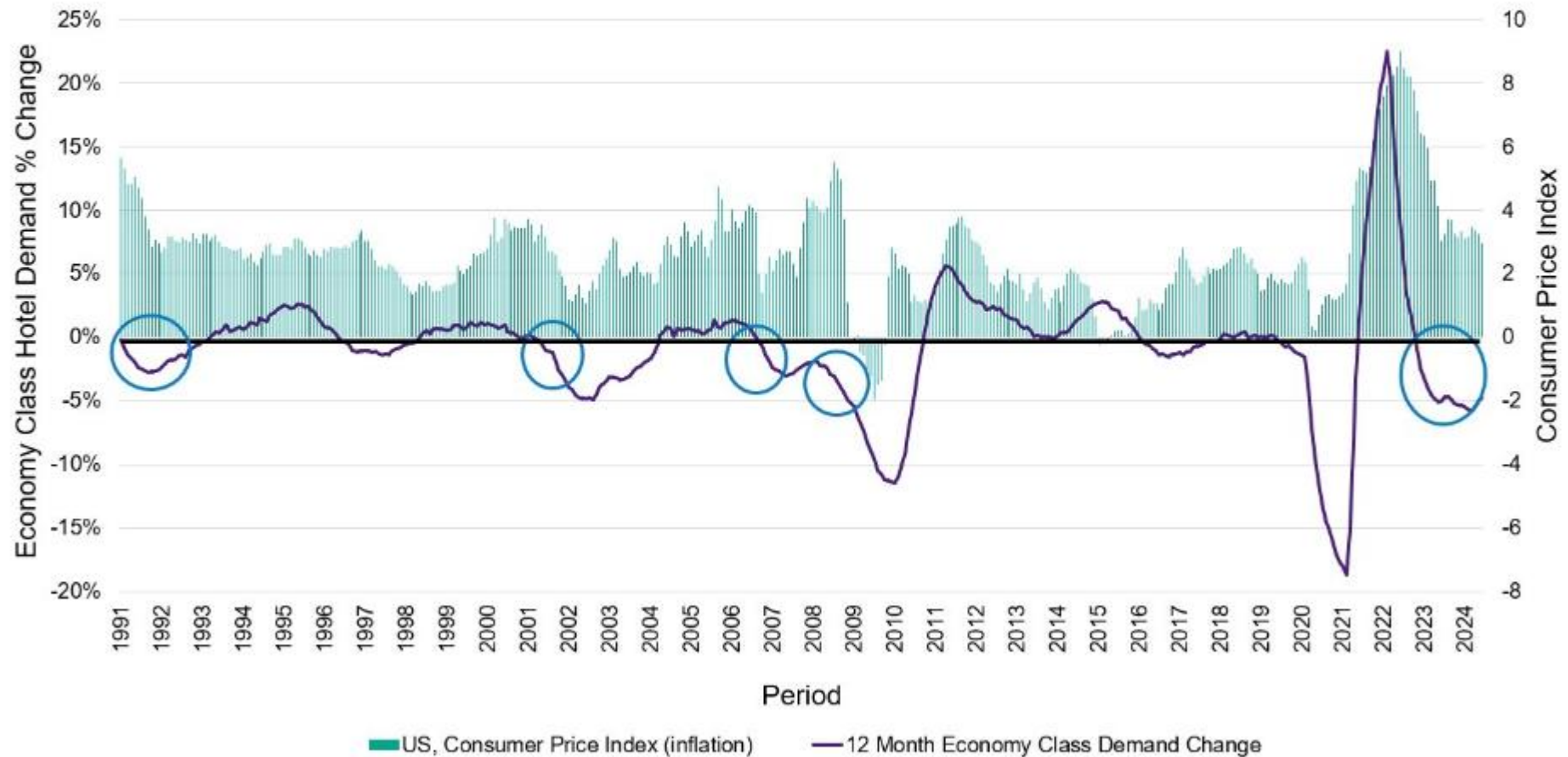
MARKET CAP RATE



The Impact of Inflation on Hospitality

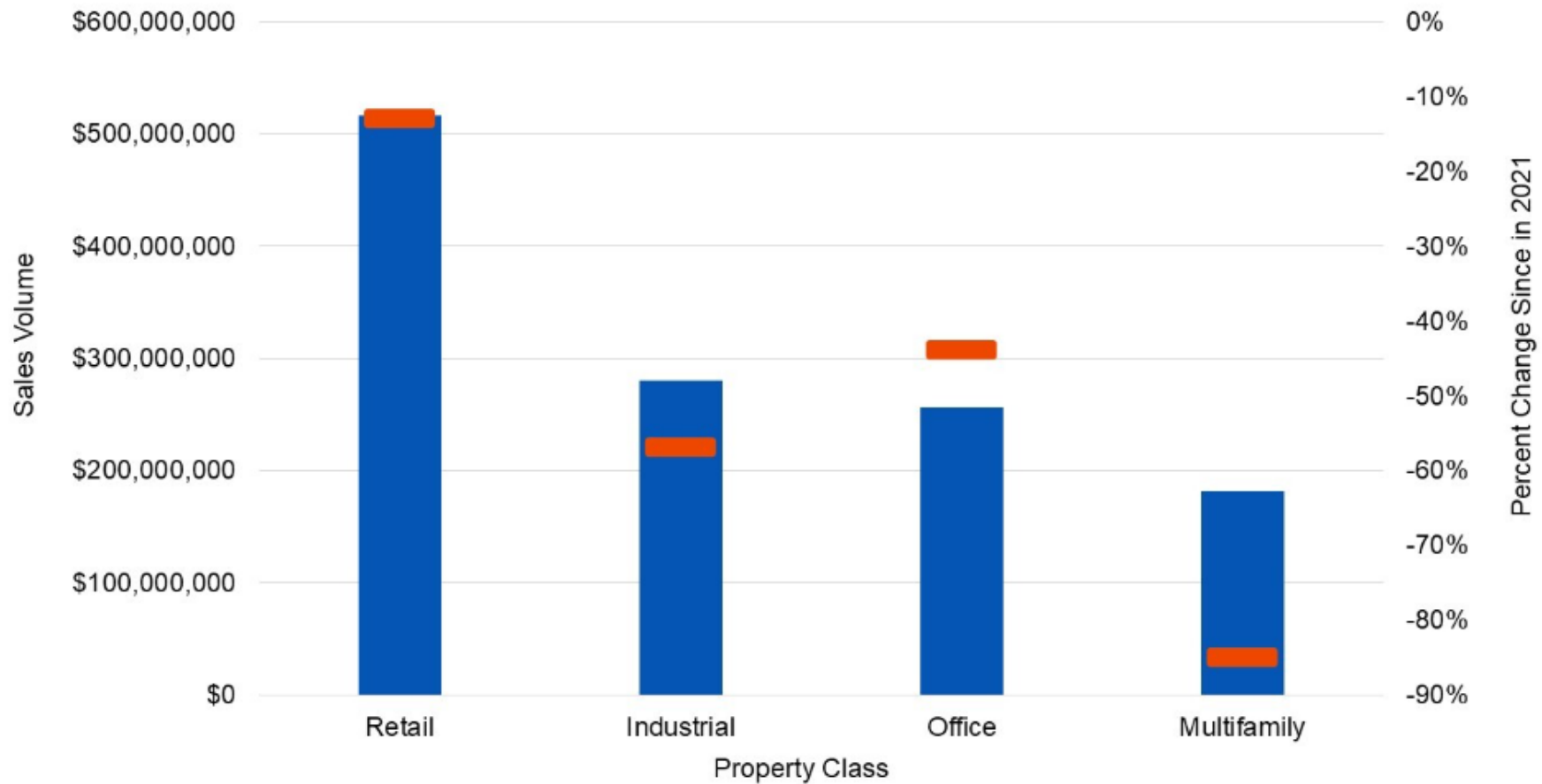


Impact on Economy Class Hotels Was Delayed in This Economic Cycle





All Property Types See Pullback in Sales



Source: CoStar, July 2024

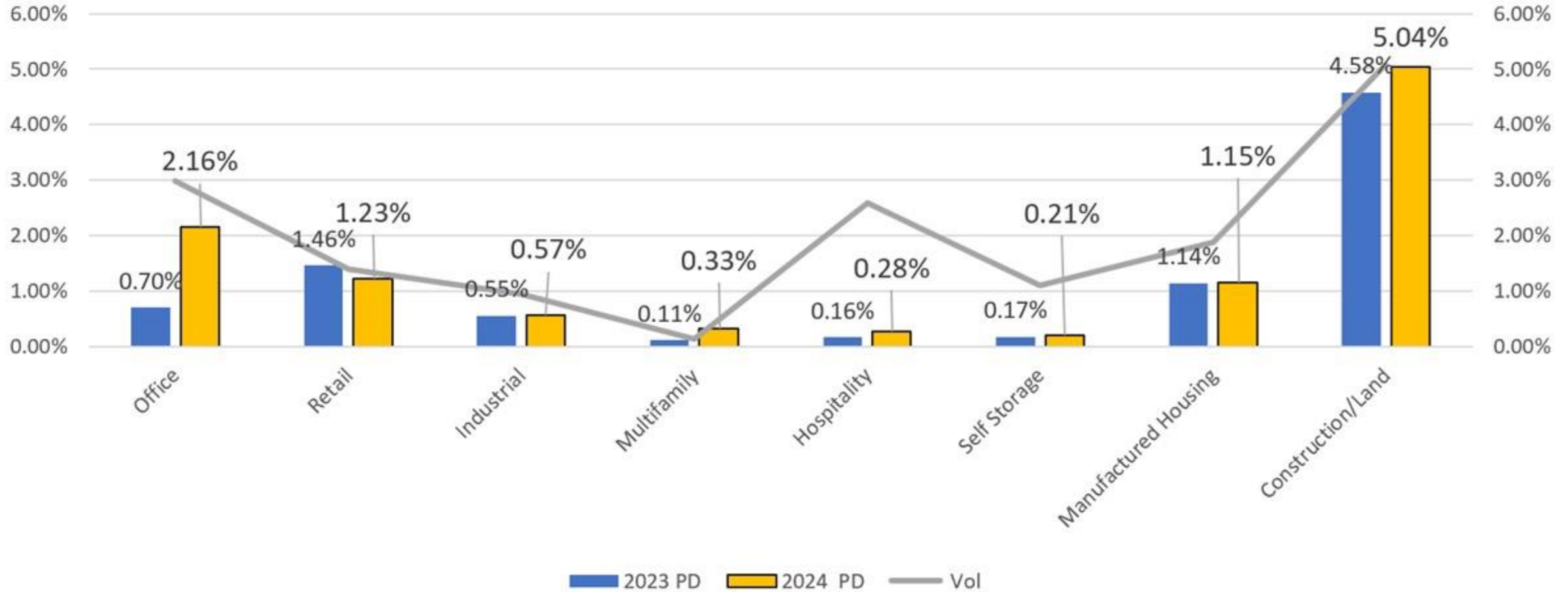
■ Year-Ending in 2024 Q2 ■ National



Industries That Are Decreasing in Credit Risk (2Q 2024)



Investor Owned CRE Probabilities of Default by Sector



Industries That Are Increasing in Credit Risk (2Q 2024)



| Oklahoma Bottom 20 Industries with the Highest Credit Risk 2Q 2024 | | | | | | |
|--|---|-------|-------|--------------------|-------------------|-------|
| Rank | Industry | NAICS | APD | YOY bp Chg. In POD | YOY % Chg. In POD | Vol |
| 392 | Inland Water Transportation | 4832 | 4.77% | 22 | 5% | 2.46% |
| 393 | Waste Collection | 5621 | 5.16% | 68 | 13% | 2.58% |
| 394 | Other Transit and Ground Passenger Transportation | 4859 | 5.74% | 47 | 8% | 2.70% |
| 395 | Couriers and Express Delivery Services | 4921 | 5.72% | 20 | 3% | 2.79% |
| 396 | Transit and Ground Passenger Transportation | 485 | 5.74% | -194 | -34% | 2.80% |
| 397 | Taxi and Limousine Service | 4853 | 5.79% | -228 | -39% | 2.84% |
| 398 | Couriers and Messengers | 492 | 5.81% | 14 | 2% | 2.84% |
| 399 | Vending Machine Operators | 4542 | 5.16% | 145 | 28% | 2.87% |
| 400 | Other Support Activities for Transportation | 4889 | 6.10% | 75 | 12% | 2.95% |
| 401 | Other Pipeline Transportation | 4869 | 5.64% | -31 | -5% | 2.96% |
| 402 | Electronic Shopping and Mail-Order Houses | 4541 | 5.46% | -26 | -5% | 3.05% |
| 403 | Transportation and Warehousing | 48-49 | 6.66% | -74 | -11% | 3.30% |
| 404 | Support Activities for Rail Transportation | 4882 | 6.68% | 8 | 1% | 3.32% |
| 405 | Urban Transit Systems | 4851 | 6.75% | 30 | 4% | 3.36% |
| 406 | Special Food Services | 7223 | 6.35% | 103 | 16% | 3.41% |
| 407 | Local Messengers and Local Delivery | 4922 | 7.01% | -90 | -13% | 3.53% |
| 408 | Specialized Freight Trucking | 4842 | 7.14% | 25 | 4% | 3.56% |
| 409 | Truck Transportation | 484 | 7.37% | -11 | -1% | 3.69% |
| 410 | Freight Transportation Arrangement | 4885 | 7.38% | 39 | 5% | 3.70% |
| 411 | General Freight Trucking | 4841 | 7.40% | -17 | -2% | 3.71% |

Industries That Are Decreasing in Credit Risk (2Q 2024)



Oklahoma Top 20 Industries with the Lowest Credit Risk 2Q 2024

| Rank | Industry | NAICS | APD | YOY bp Chg. In POD | YOY % Chg. In POD | Vol |
|------|--|-------|-------|-----------------------|----------------------|-------|
| 1 | Poultry and Egg Production | 1123 | 1.74% | 15 | 9% | 0.75% |
| 2 | Sawmills and Wood Preservation | 3211 | 2.03% | -27 | -13% | 0.76% |
| 3 | Forging and Stamping | 3321 | 1.93% | -10 | -5% | 0.78% |
| 4 | Plastics Product Manufacturing | 3261 | 1.92% | -11 | -6% | 0.80% |
| 5 | Plastics and Rubber Products Manufacturing | 326 | 1.93% | -13 | -7% | 0.80% |
| 6 | Aquaculture | 1125 | 1.84% | 34 | 18% | 0.82% |
| 7 | Hardware Manufacturing | 3325 | 1.97% | -13 | -7% | 0.82% |
| 8 | Religious Organizations | 8131 | 2.00% | -13 | -7% | 0.83% |
| 9 | Pesticide, Fertilizer, and Other Agricultural Chemical Manufacturing | 3253 | 2.09% | 11 | 5% | 0.84% |
| 10 | Securities and Commodity Exchanges | 5232 | 2.01% | -15 | -7% | 0.85% |
| 11 | Rubber Product Manufacturing | 3262 | 2.00% | -14 | -7% | 0.86% |
| 12 | Clay Product and Refractory Manufacturing | 3271 | 2.11% | -40 | -19% | 0.86% |
| 13 | Veneer, Plywood, and Engineered Wood Product Manufacturing | 3212 | 1.97% | 19 | 10% | 0.87% |
| 14 | Depository Credit Intermediation | 5221 | 2.05% | 5 | 2% | 0.87% |
| 15 | Fishing | 1141 | 2.06% | 4 | 2% | 0.88% |
| 16 | Funds, Trusts, and Other Financial Vehicles | 525 | 2.15% | -23 | -11% | 0.89% |
| 17 | Other Investment Pools and Funds | 5259 | 2.15% | -23 | -11% | 0.89% |
| 18 | Museums, Historical Sites, and Similar Institutions | 712 | 2.47% | -43 | -17% | 0.89% |
| 19 | Museums, Historical Sites, and Similar Institutions | 7121 | 2.47% | -43 | -17% | 0.89% |
| 20 | Greenhouse, Nursery, and Floriculture Production | 1114 | 2.01% | 28 | 14% | 0.89% |

2Q Pricing Trends - Summary



- Nominal spreads increased 2 bps due to lower credit supply, increased demand and deposit pressure. Average SOFR-equivalent credit spread for community banks is currently 2.55%.
- Target risk-adjusted ROE remained at 16%.
- Actual risk-adjusted ROE is 16.1% so far for the quarter.
- The average through-cycle probability of default (POD) is 0.49%, down 2 bps. from 1Q 2024. POD volatility is flat in 2Q and remains low at 0.27%.
- Expected loss given default increased 1.5% percentage points to 44.0% (due to higher cap rates).
- Average community bank portfolio expected loss increased 7bps to 0.28%, or well within bank reserve levels.
- Loan growth is projected at 7.7% in 2024, up from 7.1% from last year.

Pricing by Grade and Loan Size



| | Credit Rating | Suggested Target Spread | Actual Spread (@ Booking) | Difference (Bps) | Difference % | Target ROE | Actual ROE (@ Pricing) | Difference | Difference % | Comments |
|--|---------------|-------------------------|---------------------------|------------------|--------------|------------|------------------------|------------|--------------|--|
| | 1 | 1.91% | 2.22% | 0.31% | 16% | 16% | 14% | ⬇️ -3% | -16% | Spreads decreased by 2bp due to more competition for better collateralized loans (sub 50% LTV) |
| | 2 | 2.25% | 2.43% | 0.18% | 8% | 16% | 15% | ⬇️ -1% | -8% | Spreads increased by 3 bps QoQ. |
| | 3 | 2.55% | 2.55% | 0.00% | 0% | 16% | 16% | ⬇️ 0% | -1% | Spreads remained flat to 1Q |
| | 4+ | 2.65% | 2.79% | 0.14% | 5% | 16% | 16% | ⬇️ 0% | -1% | Spreads increased by 9 bps due to greater pricing power. |

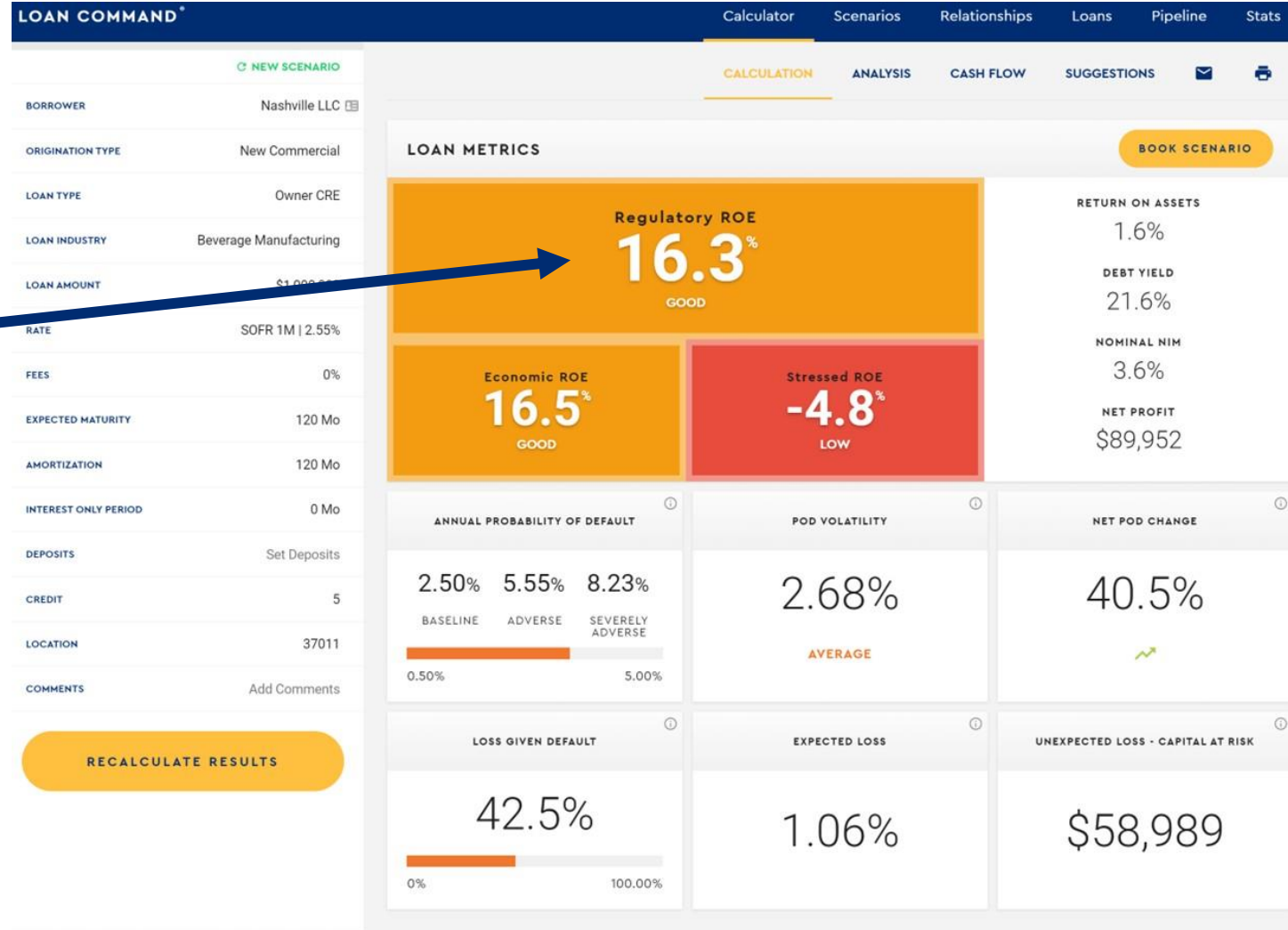
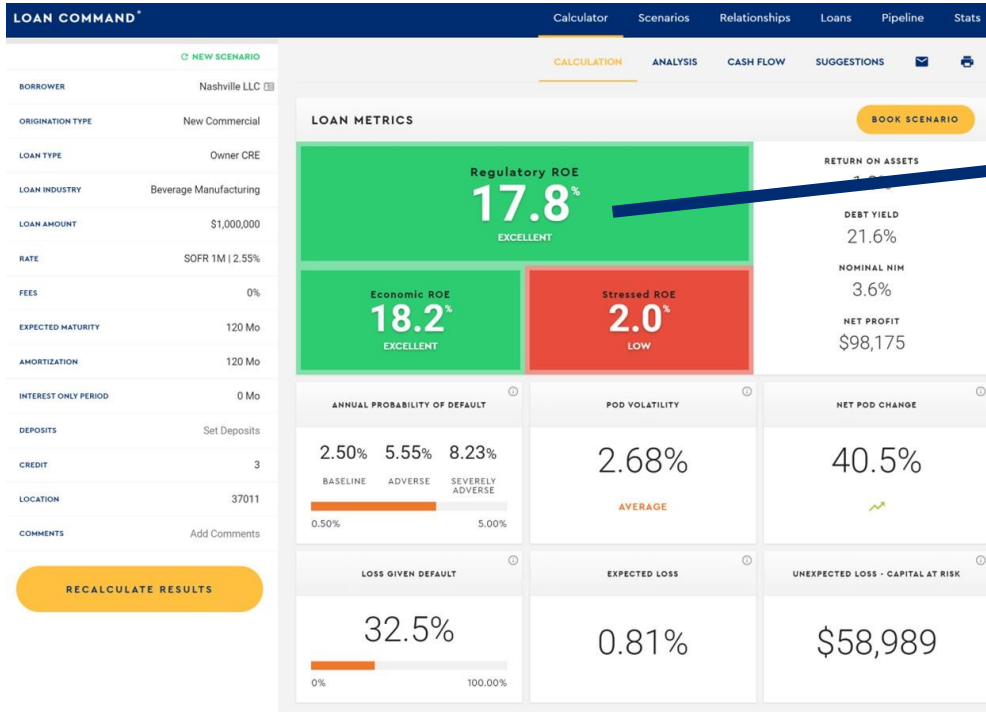
| | Loan Size | Suggested Target Spread | Actual Spread (@ Booking) | Difference (Bps) | Difference % | Target ROE | Actual ROE (@ Pricing) | Difference | Difference % | Comments |
|--|--------------------|-------------------------|---------------------------|------------------|--------------|------------|------------------------|------------|--------------|---|
| | \$50k to \$500,000 | 3.25% | 2.69% | -0.56% | -17% | 16% | 10% | ⬇️ -6% | -39% | Industry is underpricing small loans |
| | \$500,000 | 2.75% | 2.69% | -0.06% | -2% | 16% | 14% | ⬇️ -3% | -16% | Slightly underpriced |
| | \$1,000,000 | 2.55% | 2.67% | 0.12% | 5% | 16% | 17% | ⬇️ 1% | 3% | Increase of 16 bps |
| | \$2,000,000 | 2.50% | 2.56% | 0.06% | 2% | 16% | 16% | ⬇️ 0% | 1% | This remains the most competitive area but banks are showing discipline |
| | \$3,000,000 | 2.43% | 2.39% | -0.04% | -2% | 16% | 15% | ⬇️ -1% | -7% | |
| | \$4,000,000 | 2.40% | 2.32% | -0.08% | -3% | 16% | 14% | ⬇️ -2% | -10% | |
| | \$5,000,000 | 2.38% | 2.35% | -0.03% | -1% | 16% | 15% | ⬇️ -1% | -5% | Decrease of 1 bps. |
| | \$10,000,000 | 2.35% | 2.48% | 0.13% | 6% | 16% | 18% | ⬇️ 2% | 13% | This area is down 4 bps from last quarter |

Pricing By Loan Type



| | Target Spread | Actual Spread (@ Booking) | Difference (Bps) | Difference % | Target ROE | Actual ROE (@ Pricing) | Difference | Difference % | Comments |
|----------------|---------------|---------------------------|------------------|--------------|------------|------------------------|------------|--------------|---|
| NOOCRE | | | | | | | | | |
| Office | 2.65% | 2.91% | 0.26% | 10% | 16% | 19% | ▲ 3% | 18% | Mostly all refinance volume. Spreads increased 5 bps over 1Q |
| Retail | 2.80% | 2.76% | -0.04% | -1% | 16% | 18% | ▬ 2% | 14% | Spreads decreased by 2 bps due to better credit outlook and firmer rents. |
| Hospitality | 3.20% | 3.14% | -0.06% | -2% | 16% | 22% | ▲ 6% | 38% | Hospitality pricing decreased 3 bps due to higher performance |
| Industrial | 2.25% | 2.19% | -0.06% | -3% | 16% | 17% | ▬ 1% | 6% | Spreads increased 4 bps |
| Multifamily | 2.35% | 2.18% | -0.17% | -7% | 16% | 13% | ▬ -3% | -20% | Spreads increased 6 bps. |
| Other | 2.50% | 2.73% | 0.23% | 9% | 16% | 19% | ▲ 3% | 18% | Self-storage, MH, etc |
| C&I | | | | | | | | | |
| General | 2.45% | 2.23% | -0.22% | -9% | 16% | 16% | ▬ 0% | 0% | Pricing increased 13 bps |
| Line of Credit | 3.00% | 2.80% | -0.20% | -7% | 16% | 12% | ▬ -4% | -25% | Pricing remained largely unchanged from last quarter |
| Municipal | 1.80% | 1.81% | 0.01% | 1% | 16% | 13% | ▬ -3% | -19% | Cost of muni deposits is hurting profitability. Pricing increased 3 bps from 1Q |
| Other | 2.45% | 1.80% | -0.62% | -25% | 16% | 13% | ▬ -3% | -19% | Skewed towards higher quality and long term project finance |
| OOCRE | | | | | | | | | |
| Industrial | 2.20% | 2.38% | 0.18% | 8% | 16% | 16% | ▬ 0% | -3% | Loans to manufacturing and distribution companies increased 6 bps |
| Office/Retail | 2.55% | 2.64% | 0.09% | 4% | 16% | 17% | ▬ 1% | 8% | Spreads increased by 6 bps |
| Medical | 2.15% | 2.19% | 0.04% | 2% | 16% | 14% | ▬ -2% | -14% | Spreads increased by 5 bps |
| Church | 2.90% | 2.56% | -0.34% | -12% | 16% | 15% | ▬ -1% | -6% | Underpriced given elevated risk. Spreads increased 10 bps. |
| Other | 2.45% | 3.06% | 0.61% | 25% | 16% | 21% | ▲ 5% | 33% | Restaurants, child care, etc. Spreads increased 4 bps |
| Other | | | | | | | | | |
| Other | 2.45% | 2.97% | 0.52% | 21% | 16% | 21% | ▲ 5% | 34% | Mostly ag loans. Spreads decreased 16 bps |
| Construction | 3.25% | 3.15% | -0.10% | -3% | 16% | 5% | ▼ -11% | -66% | Elevated risk increased pricing by 8 bps |

ROE Targets ARE Reduced YOY



Banking Industry Challenges and Opportunities

