# TIME TO CHANGE CHANNELS

by Steve Brown

The problem with summertime television is that nearly all shows are repeats. This can lead to increased channel flipping, as boredom is amplified. As with summer television, independent bankers look like they too will be caught up in the same boring yield curve environment for the next 3 years (if one believes the forward interest rate markets) or perhaps even longer. Imagine a world where one can only sit and stare at a television with a single station selection. No matter which button is clicked, the same shows play over and over and over all day long. In the world of an independent banker, it seems that is exactly the case as of late. The forward curve currently predicts that long-term rates will remain low, while short term rates will stay close to current levels. Right now the curve is inverted, telling us that customers will continue to press their banks to capitulate and give them long-term fixed rate loans. After all, with Prime hovering at 8.25% and 10 year fixed rate loans being originated closer to 7.00%, only a crazy customer would choose to float. Independent banks already stretched to their maximum acceptable risk tolerance in many cases (in fixed rate lending exposure) and are looking elsewhere to relieve the pressure. One common way many banks will do this is to sell a percentage of their long-term fixed rate loans they originate to a broad range of financial companies. In such cases, independent banks receive an up-front fee of 1% to 2%, while such financial companies, in turn, clip the coupon over the life of the loan. As long as these companies can line up reasonable funding to support such assets, the transaction turns out to be a pretty nice one. Let's take a closer look, however and run some specific numbers to analyze just how good a deal the transaction can be. We begin with a $5mm amortizing loan carrying a 10 year maturity and based on a 25 year amortization schedule. There is a 2% fee available for any independent bank interested in selling loans into the program. On the independent bank side of the transaction, the bank will book $100k (2% x $5mm) less any origination costs it incurs. What the bank loses, among other things (assuming a 7 year maturity), are the cross-sell opportunities and any additional loans that may come from this customer (as well as any related parties). Given that the loan has just been locked away for 7 years, this is significant. On the purchaser side of the transaction, things are different. These programs nearly always require prepayment penalties be inserted, essentially extending the loan's maturity and significantly reducing the motivation of the client to refinance. This gives the purchaser more time to clip the coupon and increases their return. Assuming a 4% NIM and a 7 year expected loan life, we calculate that the purchaser stands to collect about $1.164mm in profit contribution (i.e. the present value of the cashflows discounted at the 4% NIM received). Not only is finding new customers a difficult process, but if the forward curve is correct, many will demand long-term fixed rate loans. Since most independent banks cannot easily fund long-term assets, a solution must be found. Selling long-term assets is one way, but given the profitability skew of such a transaction, bankers may want to flip channels now and again to see what else might also be on their financial television.

## BANK NEWS

**Acquisition**

MainSource Financial ($2.4B, IN) will acquire 5 branches from First Financial Bank ($2B, IN) for an undisclosed amount. The deal includes nearly $29mm in loans and $51mm in deposits.

**Acquisition**

Minnwest Corp ($1.1B, MN) will acquire Rochester Bank ($41mm, MN) for an undisclosed sum.

**Alliance**

BNC National Bancorp ($740mm, ND) and Palisade Asset Management (MN) have entered into an agreement whereby Palisade will manage nearly $250mm in bank assets. The two companies will share investment management personnel and expenses and Palisade will increase its services to include wealth management.

**Acquisition**

Morgan Stanley will acquire Glenborough Realty Trust for about $840mm in cash (including debt, the deal is valued at $1.9B). The acquisition gives Morgan Stanley 45 properties with about 8mm square feet of space and significantly boosts its real estate unit.

**Acquisition**

Wells Fargo will acquire private investment firm Barrington Associates (CA) for an undisclosed sum. Barrington has over 35 investment bankers on staff and advises companies with revenue between $25mm and $1B on M&A deals.

**Fees**

It is estimated that nearly 43% of consumers pay no monthly fees for banking services, according to a recent industry report. The study further found that 14% pay $3 or less, while 6% pay $6 to $8, 8% pay $8 to $10 and %15 pay in excess of $10.

**Job Changes**

Pressure from compliance issues and shareholder demands have led executives to change jobs at a more frequent rate. A recent study found that 15,650 managers from CEOs to VPs changed jobs during the 1H 06, compared to 6,489 the prior year. Over the same time period 1,256 CFOs left their companies, compared to 881 in 2005.