LOAN PRICING

by Steve Brown

Don't let their cute looks fool you. They come to you seemingly kind and docile, only to tear everything apart. We are talking about your customers, but there is a distinct parallel to raccoons. We say this, because we think the raccoons in our area are definitely up to something. Usually, the wildlife waits until 3am to raid the trash cans, but recently they have been hitting before nightfall. They are so aggressive, it is only a matter of time before they will be letting themselves in and coming to dinner. Like leaving a slab of tri-tip at the bottom of a trash bag, many bankers have trained their depositors to be just as aggressive when it comes to rates. Where we used to see deposit promotions marketed for as long as 12 months, they are now as short as a matter of weeks. Running promotions too frequently results in "deposit fatigue," whereby customers start to ignore all marketing. Those that don't ignore the promotion usually set a "mental filter" that first looks at rate as an easy point of comparison. In other words, running promotions too frequently trains customers to be interest rate sensitive. One commonly held belief among banks indicates that running promotions over limited time periods keeps the amount of high rate customer balances in check. Here is a good rule of thumb - if this is your strategy, chances are you are accomplishing the opposite. Banks that are anxious about taking on too much rate sensitive volume, are conducting the wrong promotion. If this is the case, it is far better to borrow from wholesale sources, such as the FHLB or brokered CD markets. Instead of spending resources on rate-based promotions, banks should put more effort into developing deposit marketing campaigns around service attributes. Banks did this wonderfully at the start of 2006 in money market accounts. The problem is, they worried about the competition and service promotions quickly turned to rate. Several banks have run 2 MMDA promotions a month. In August, for the first time, we saw some banks take their whole MMDA class from profitable to unprofitable by aggressively promoting on rate. These banks paid sky high rates (5.50% or greater). After taking into account transaction costs (commissions, marketing, etc.) and cannibalization, this funding cost these banks an effective 11%. Further, since some of the cannibalization came out of longer-term CDs that were rolling over, these banks dramatically shortened their effective duration. For 2007, the battle is going to be over the checking account. A well thought out marketing campaign should occur over a 3 to 12 month period. Bankers that insist on running frequent promotions will only end up inviting hungry raccoons right into their bottom line.

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BANK NEWS

M&A

UCBH Holdings ($8.3B, CA) will acquire Summit Bank ($656mm, GA) for about $175.5mm, or 2.99x book.

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State Bank of Cross Plains ($498mm, WI) will acquire Independent Bank ($116mm, WI) for an undisclosed sum.

Way Down

A survey of homebuilder optimism fell to its lowest level in 15Y, as the backlog of unsold homes spiked. Over the past 12 months, inventories have climbed 40% and now sit at a 7.3 month average supply. Meanwhile, the number of signed purchase agreements for homes fell 7%, the biggest percentage drop since the 9/11 attacks.

CRE Exposure

As of June, roughly 25% of banks had construction and land development loans equal to more than 100% of their risk-based capital.

Dropped

The American Inst. Of CPAs indicated it will drop its project on improving loan loss disclosures because they have been deemed to be too burdensome. Under the proposal, detailed disclosures such as geographic, type and credit grade ranking, would have been required to support allowances.

CEOs Leaving

So far this year, 728 CEOs have left U.S. companies, or about one every 6 business days.

Construction Sector

The FDIC is reporting that during the first half of 2006, the national number of construction loans that had slipped to non-current had soared by 13%, the first increase since 2002.

LOAN PRICING

In Aug., construction delinquencies increased. The question is, has your loan pricing incorporated this change? If you were using our Loan Pricing Model, you would have the latest probabilities of default and would have already adjusted pricing. If you are not using our model, then chances are you are more reactive to the market, than proactive. To find out how our model works, join us for a free online presentation today at 9am PT. To register, follow the link at the bottom of this page, use password "big123" then click "Enroll" up at the top left of the screen.