CRE CONCENTRATION EDUCATION

by Steve Brown

Writing policies can be a bit like playing with Play-Doh. Just when you think something is starting to take shape, you realize you have no idea what you are making. After doing that a few times, if you are like us, you end up rolling out a snake and calling it a day. Creating a bank policy is a lot like molding Play-Doh. To help community bankers meet regulatory guidelines on commercial real estate ("CRE") concentrations released in December (up to 70% of community banks may fall under this requirement), we provide a primer on what bankers should consider as they prepare to modify policy components. To begin, the guidance itself indicates that one of the primary drivers behind the change was the fact that examiners had found a decent number of banks with concentrations that lacked appropriate policies and procedures to manage the risk. In short, the focus of the guidance was that banks must be able to provide the management and board with the information necessary to assess the CRE lending strategy and policies in light of changes in market conditions. The guidance went on to say that regardless of bank size, institutions must be able to identify and monitor CRE concentrations and the potential changes market conditions may have on their risk profiles. In regulator speak, that basically amounts to better systems and updated policies. When it comes to modifying policies, while every bank is different, there are key areas starting to take shape as best practices. Specifically, policy limits should be employed at the sector, sub-sector, geographic or by other contributing factor. Examples of sector concentrations should include a split between non-income and income producing properties. Under non-income producing, banks should identify and stratify raw land, acquisition and development and construction. Banks should know the percentages of each and have board limits based on risk factors that can change over time. On the income producing side, banks should break out CRE and multifamily as an example. To ensure borrower diversification, banks may also want to consider applying special monitoring and reporting on credits that represent more than 1.5% of total assets (i.e. a $1B bank should more closely monitor credits above $15mm). Drilling down another level from setting sector-related policy limits, we come to sub-sector. In the non-income producing sector, for instance, bankers should identify and set limits on residential construction percentages and within that, how much is speculative vs. pre-sold. The same approach could be taken with commercial construction, where the bank tracks and reports pre-leased and committed takeout percentages. Moving to geographic policy considerations, bankers should identify state and metropolitan (or county) concentrations and recognize they are probably going to be highly geographically concentrated. Once that data is captured, it can then be tracked against economic and market data for the area and exposure limits can be further refined. The fact that most community banks have a geographic concentration risk means policies should reference that and provide specifics as to how the bank plans to diversify (i.e. 10% lending in outside areas, etc.). Finally, bankers should include other contributing factors that may affect portfolio performance. For example, a lender financing retail centers should be able to ID and track lead tenants. If 20% of lease exposure comes from Toys"R"Us, then the bank has a concentration risk. Banks should be able to identify and stratify concentrations to both lead tenant and industry. Because the guidance impacts so many community banks, we'll explore these concepts further in forthcoming issues. Until then, bankers should begin molding policies and procedures to ensure compliance and control concentration risk.

BANK NEWS

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PremierWest Bancorp ($1B, OR) will buy the consumer finance division business from Pacific Continental Bank ($890mm, OR) for an undisclosed amount. The deal will include $11mm in consumer finance loans to existing employees of Pacific Continental.

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American National Bank ($1.5B, TX) will buy Bryant-Irvin Bancshares ($140mm, TX) for an undisclosed sum.

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Yadkin Valley Financial ($1.1B, NC) will buy Cardinal State Bank ($193mm, NC) for $39.8mm, or about 1.9x book.

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First National Bank of St. Louis ($1.3B, MO) will buy First National Bank of Millstadt ($90mm, IL) for $21mm or approximately 1.8x book.

Cards

A recent study by TowerGroup finds 70% of payment card spending is done with cards that offer loyalty programs. This feature is becoming an essential aspect in the ever increasing competition of the payment card world.