ALL-STAR REVOLVING LINES OF CREDIT

by Steve Brown

Aside from being amazed after watching Seattle Mariner Ichiro Suzuki hit the first ever inside-the-park home run at an All-star game, we learned two other important things last night. One came in the 5th inning after a drunk guy fell down the stairs and failed to immediately get up. This event underscored the difference between men and women. Given the choice between watching what happens to a fly ball and helping another human in distress, most women will immediately go to the person's aid, while men, will first consider if there is a man on base. The second thing we learned is that after talking with two business owners sitting on either side of us, neither one had been offered a revolving line of credit by their community bank - despite having a formidable balance sheet. When it comes to C&I lending, community bankers often overlook the use of revolving lines of credit. The, when they do offer it, they often end up putting a line in place for only 1Y. The though is that a 1Y maturity gives the bank the opportunity to review credit and control items like rate, amount and maturity. The problem is that a short maturity also reduces profitability of the loan and gives both sides the opportunity to frequently renegotiate pricing. After reviewing a representative sample of 65 revolving lines at 15 banks, we found that more than 60% were extended without any modification. Further, 15% were terminated by the customer, 14% were changed in a manner that reduced profitability (either increased the risk or lowered the pricing) and 5% included a change that neither improved nor reduced profitability. Only, 6% were reviewed and not renewed for credit or pricing reasons. Through our profitability work, we have calculated that the average cost to review, approve and negotiate these lines is roughly $630 per line of direct cost and another $8,414 of indirect costs. While you can't do much for the indirect costs (those are essentially fixed for the sake of this discussion), assuming an average line amount of $750k, the direct cost alone eats into an approximate 8bp per annum of margin if fully drawn and more if only partially utilized. By connecting the dots above, an obvious process improvement is to move standard 1Y maturities to 3Y maturities. This saves processing resources and mitigates some of the risk that the client will seek to renegotiate. While many banks feel that a longer maturity increases risk, we would argue the opposite. The greatest risk, statistically speaking, is one of missed opportunity cost. Credit risk from a longer maturity can be largely offset by implementing stronger covenants that allow for termination or increased pricing if certain items are not met (such as the submission of financials, liquidity or debt service coverage). What the bank loses in pricing flexibility, it gains by not having to renegotiate terms annually that end up being unfavorable (or add little value) to the bank. In addition, the longer maturity adds approximately 0.8 in average life (thereby increasing the cash flow stream). While many banks pursue corporate business, a majority have still not rounded the bases over how to package profitable revolving lines of credit. Most small and medium sized business would appreciate a source of liquidity, but it is rare we see these lines included in a packaged relationship (and is often one of our more common recommendations to increase profitability and acquisition rates). Like National League All-star victories, community banks could win more business by more efficiently leveraging using revolving lines of credit.

BANK NEWS

Credit Rating Cuts

Moody's Investors Service said it slashed credit ratings on $5.2B of bonds backed by subprime mortgages, a potential trigger for a large-scale reevaluation of this asset class. Meanwhile, Standard & Poor's has threatened to cut the credit rating of more than $12B of bonds backed by subprime because of evidence of increasing delinquency, default and loss on subprime home loans. The rating agencies are taking the action as credit support has significantly exceeded "historical precedent."

New Deposit Strategies

Holistic rewards programs and free credit monitoring are two ways bankers are attracting new deposits now that free checking has become commonplace in the industry, according to a study by Synergistics Research.

Housing Woes

Home builder D.R. Horton said net sales orders fell 40% in its most recent quarter, as the company announced its first quarterly loss since 1995. The company called the environment "challenging" and indicated in CA orders fell 62%. Meanwhile, the company reported cancellations increased to 38% from 32% in the prior quarter.

Credit Cards

In a reversal of long-standing policy, Capital One Financial said it will share information regarding cardholders' credit limits with credit bureaus.

Mobile Banking

ING Bank has unveiled a new mobile banking service dubbed "Orange Mobile." The service will let customers check balances, transfer funds, locate ATMs and check the status of payments and pending transactions from a mobile phone.

Pensions Dropping

A new study finds 67% of employers that offer pension programs to employees have closed them to new hires, frozen them for existing employees, or plan to do so within 2Ys.