

FORWARD LOAN COMMITMENTS

by [Steve Brown](#)

From earliest recorded history, humans have been concerned with the passage of time and its changes. Time has been measured by tracking the sun's movement across the sky, using oil lamps with a marked reservoir, sandglasses, sundials, quartz crystals and atomic clocks. The march of time brings risk and, as bankers, we spend effort mitigating the impact of time on business. In today's market of interest rate volatility and credit uncertainty, borrowers are concerned that the passage of time may jeopardize their project. After today's expected rate cut and the ones likely to occur in the near future, inflation will raise its ugly head. When that occurs, every borrower in the market will be asking their banker how to lock in loan rates to prevent rising interest rates from eating away cash flows. In many cases, borrowers will want to lock in a rate immediately. Bankers must understand the borrower's motivation in seeking such structures, the risk associated with complying with such requests and the optimal way to be compensated. For community banks, there are 3 typical requests to lock commitments. The first and simplest form of locking in future events is the use of fixed-term loans. In this circumstance, the borrower aims to eliminate the variable expense of interest payments. Bankers obviously understand that fixed rate loans may not match well with their funding sources (an ALM issue). Bankers must also grapple with the cost of embedded optionality of fixed rate loans and eliminate that optionality with loan prepayment penalties. Unfortunately, many bankers have succumbed to competition and price loans below the structure's economic value. Thus they have the potential to carry a liability on the books (as opposed to an asset). The second form of locking in a rate is by use of a forward commitment. A fixed rate term loan starting after a 1Y construction loan is such an example. The borrower is willing to sign documents today for both an interim floating loan (for construction) and a fixed rate loan, with a set rate, that starts at some specific date in the future. The bank's risk has now been magnified for both market and credit risk. At the time of the fixed-rate loan commencement, both interest rates and credit spreads may be different than originally anticipated. The final and most complex form of risk management is the use of pre-loan documents to lock in structure and rates. An example of this is where the borrower seeks a binding commitment from the bank for a fixed-rate loan, but certain conditions precedent are yet to be met (for example, subject to a satisfactory appraisal or environmental report) and loan documents have yet to be signed. In this last case, borrower and lender agree to commit in the future and define the substantive terms and conditions of the final agreements in the form of a letter. Here the borrower gets the largest benefit of the commitment because of the variety of options that they hold. Bankers must be diligent in documenting and securing the borrower's obligation under a forward commitment (typically a legally binding commitment letter). We have helped many bankers achieve the above stated loan arrangements with forward fixed rate locks 2Ys in advance and forward commitments up to 6 months in the future. You could say that we built a better loan clock to help our customers eliminate the vicissitudes of time.

BANK NEWS

Housing

The latest study from RealtyTrac finds the number of people heading for foreclosure (i.e. received default notices) more than doubled in August compared to the prior year. The number was the highest ever recorded by the company. Overall, NV had the highest rate (1 filing for every 165 homes) at more than 3x the national average (1 in every 510), followed by CA (1 in 224) and FL.

Bank Sold

American Express has sold its international banking unit to Standard Chartered Plc for about \$1.1B as it focuses efforts on credit cards. The move doubles Standard's U.S. dollar-clearing business, adds \$22.5B in assets under management and gives the bank branching licenses in India and Taiwan.

Moving Stagecoach

Wells Fargo said it has launched a browser-based mobile banking application for small businesses nationwide, dubbed Wells Fargo Mobile. The service allows customers to check personal and business deposit and credit account balances, view transaction history and transfer money between Wells Fargo accounts.

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