SUMMER VACATION AND HOSPITALITY LENDING

by Steve Brown

Depending on where you travel this summer, you will finally be able to use your laptop and Wi-Fi on your airplane. That's right - Alaska, American, Southwest and Virgin America say they will allow customers to surf the internet for about $10 bucks per flight. That is a very good thing for community bankers, since keeping up with moment-to-moment changes in the economy (and shifting conditions in lending sectors) are becoming more difficult.

Take for instance the hospitality sector. There is no doubt that consumers are retrenching amid the economic slowdown, travel plans are being curtailed and businesses are tightening down on travel budgets. In fact, 1Q numbers show marquee-name hospitality chains saw their revenue per available room slow to about 2%. While still positive, it is nonetheless weaker than the 5% growth rate most were expecting.

There is still plenty of good news to go around for community banks lending into this sector, however. For one thing, certain geographic areas are particularly hot right now including: Hawaii, Los Angeles, Manhattan, Orlando, Portland, San Diego and Seattle. For another thing, a weak dollar is already boosting travel into the U.S. for the summer.

That doesn't mean banks should get complacent. Specifically, community banks have found successful hospitality operations share common traits, including a focus on the business traveler. Specifically, recent studies find business travelers will seek out hotels that allow them to be as productive when traveling as they are in the office (78%). This means they want updated technology in the room (70%), complimentary high-speed internet access (52%) and high-quality bedding (13%).

Going "green" can also help boost borrower performance. Business travelers really do care about the environment, which is why 34% say they actively seek out hotels that are environmentally friendly and 28% would pay a 10% premium to stay in a "green" hotel. Services that help differentiate hotels and increase borrower profitability in this category include offering/touting such things as recycling, energy efficient lighting, placing cards in rooms that allow guests to request sheets/towels not be changed and using environmentally-safe cleaning products.

Banks should also take note that the hospitality sector has historically tracked closely with GDP. Given that GDP is below 1%, bankers should expect to see lower bookings and revenue over time. It appears the sector is in the latter stages of expansion, so bankers should not lose sight of that fact when originating and evaluating new loans. Given the weak economic picture, the effect on industry fundamentals is probably going to tilt toward lower performance over the medium term, so bankers should make sure they are prepared.

In general, the hospitality sector continues to perform well, but lenders have been taking steps in the past few months to tighten underwriting standards. Specifically, banks are now seeking deals with an LTV of 65% (compared to 75% last year); are calculating cashflows based on recent history (not giving credit for potential upside); are seeking out higher-quality locations; are more closely evaluating the borrower's track record/experience to reduce potential defaults/problems; and are examining the proposed brand/management of the proposed property in detail. When originating new hospitality loans, banks are clearly focusing more effort on established properties with stronger cashflows and better positioning given current expectations for a consumer-led slowdown.

Make no mistake - hospitality lending is still a profitable sector for community banks, but risks are emerging. Banks that understand and modify exposures now will ensure their bank has many fun-filled summer vacations yet to come.

BANK NEWS

M&A

Capstone Bancshares ($120mm, AL) agreed to purchase Security Federal Bancorp ($60mm, AL) for an undisclosed price.

Lehman

The WSJ is reporting that the investment bank will report its 1st quarterly loss since going public in 1994. The firm seeks to raise $4B in capital, which is on top of the $6B it already raised.

College Loans

Some of the largest U.S. banks are no longer extending loans to students at community colleges, for-profit universities and certain 4Y colleges. According to a financial aid official in CA, Citibank has even stopped making loans to all community college students in the State.

Web-Banking

According to a Synergistics Research survey, consumers below 50Ys of age amount to 60% of the Internet-banking market. Almost 50% of web-banking users have online savings accounts and 41% have checking accounts.

Muni Deposits

While an expensive source of funds in 2007, in 2008 public deposits are getting cheaper, due to lower rates and more relaxed collateral requirements. More important, many local municipalities are pulling out of state-administered investment pools, due to poor performance. The result - community banks may find more deposits for the asking.