PIRATES OF LOAN PERFORMANCE

by Steve Brown

Yesterday, it seemed like you couldn't throw a rock in corporate America without hitting someone that wanted TARP capital. Banks, credit unions, finance companies, auto manufacturers, municipalities and even Somalian Pirates have put in for capital. It is a good thing too, as commercial loan delinquencies continued to ratchet up in Oct. Given the speed at which the market is deteriorating, it appears certain most banks are going need an extra buffer. If you haven't considered cutting dividends or have turned your back on TARP, you might want to reconsider.

While pirates are stealing oil and cargo, the market has been stealing precious capital. November looks like it will go down as the month with the largest negative movement in CRE probabilities of default since as far back as 1995. On average, it appears community bank CRE delinquencies will jump 3.22% for the month (a 38% annualized rate) from 2.12% to 2.20%. In addition, 10 of the 21 sectors monitored in our Loan Pricing Model look like they will hit a 6Y high when we produce final numbers for Nov. Similar to Oct., loans to retail properties look like they will experience the biggest problems and be the worst performing sector of any category. Small business bankruptcies, lease cancellations/defaults and very low lease-up rates (many geographic areas are even negative) look like they will continue to produce declining debt service coverage. Over the past month, banks using our Loan Pricing Model have found that they had to increase pricing levels on the average loan by 7bp, in order to maintain the same projected return on capital.

Next to retail, hospitability and manufactured housing look like they will also produce large (10%+) increases in delinquencies in Nov. These sectors will likely be followed by all construction areas (residential, commercial & multifamily), office and finally, industrial. Each of these sectors will likely see delinquencies increase by at least 5% for the month. Residential construction is projected to see the highest delinquency rates at 5.32% (up from 5.05% in October) of any community bank lending sector.

On the positive side, self-storage lending is seeing resurgence, as storage vacancies are projected to decrease for the month as debt service coverage increases. Probabilities of default are projected to drop from 2.5% to 46bp. Meanwhile, production agriculture loans are expected to be the next best performing sector (with a 1.03% probability of default, down -0.4%). After that, multifamily is projected to be unchanged for Nov. (at 1.14%), leaving it the best performing sector in banking for 2008 to date (and probably for the year).

These large movements in delinquencies/probabilities of default underscore why banks need a Loan Pricing Model to better manage capital and communicate return goals throughout the organization. No matter how experienced your loan officers are, they most likely do not have an appreciation for how deposits, volatility, delinquencies, recoveries and general loan performance effects loan pricing in this market. Our Loan Pricing Model starts at a mere $500 per month, carries no upfront charges and can be cancelled at any time. While many banks are trying to cut costs during this difficult period, one area bankers will need to spend money is on are tools to help manage risk, protect capital and produce a suitable return for shareholders. Don't let the market continue to board your bank and catch you unaware. If you would like more information or a trial of this model, respond to this e-mail and we will get your bank the latest defense against sub-performing loans and deliver lenders the offensive tools they need to structure profitable assets.

DEPOSITS

Well-capitalized banks can tap into our Portfolio Deposit Program and receive brokered money market deposits priced currently at 2.05%. Pricing is the higher of 2.05% or +55bp over the most current Fed Funds Target rate. This Program provides banks with the flexibility to return deposits with a 14-day notice. Although these are money market deposits, historically monies have been left on balance for more than a year. Please call or email to see how this program can help lower a bank's funding cost.

BANK NEWS

Fed Speak

Banks still pondering whether or not to take TARP capital may want to know that FOMC Vice Chair Kohn said in a recent speech that the credit crisis is "likely to be considerably more severe than in past episodes."

Housing Recovery

A new study by the CBO finds the best case scenario for a housing recovery is the end of 2009, while the worst-case outlook is 2012.

Hope For Homes

HUD announced expansion of a program that will increase LTV qualifications to 96.5% for borrowers whose payments make up less than 31% of their month gross (and whose debt is less than 43%). If homeowners qualify, subordinate lien holders will receive payment for releasing their liens and lenders will extend amortization to 40Ys.