BREAKING ROCKS AUSSIE STYLE

by Steve Brown

Last week we wrote quite a bit in this section about deposits and funding, so this week we thought it only fair to give lenders their due. Since we are talking about lenders, we also thought we should remind everyone that on this day back in 1788, Captain Arthur Phillip effectively founded Australia (originally planned as a penal colony) with a group of 700 convicts and some British soldiers. We felt this was a good analogy not only because of the date, but also because many lenders tell us they feel so inundated with problems they feel like they are chained to the desk and are destined to break rocks (i.e. work on problem loans) forever.

For lenders, it is an understatement to say things right now are rough. However, this is a tough group to begin with, so today we point out some actions bankers can take in an effort to make the next examination a little bit easier.

Start with delinquent loans. Make sure you have a well documented plan for each loan. Be careful when giving customers more time, as it can lead to deeper issues (so extensions should not be given easily). Wherever possible, focus on getting more borrower "skin in the game" to help protect shareholder interests when loans begin to underperform.

Zero in on construction loans. This is a regulatory crack down point, so bankers must be prepared. Heavy documentation is required here including tracing loan disbursements for each project, identifying preservation steps, determining the cost to complete and understanding feasibility of completion. Bankers are going to have to spend money to protect their interests on construction projects, so be prepared to ramp up inspections and update appraisals as needed. For projects that are underperforming, it is important to conduct funding "forensics." This process helps the bank by providing a full accounting analysis of where and how the loaned funds were spent in an effort to better understand and control how problem loans/losses may have developed.

Focus next on reserve adequacy. The ALLL should be thoroughly documented, comprehensive, systematic and consistently applied. Historical loss is fine as a starting point, but recent trends, qualitative factors, changes in the economic/business environment, modifications to lending policies/underwriting standards and a shift in the volume/severity of problem loans should all be considered. Over-documenting this process, being consistent month-to-month and reporting to the Board are all part of proper ALLL management. Given so many declining credit-quality trends right now, bankers and boards should expect the ALLL level as a percentage of the portfolio to be generally increasing (barring unusual charge-off activity of course).

Reach out to borrowers. Many loans on the books were originally backed by sound borrowers but times have changed. Bankers need to be proactive and think outside the box in an effort to avoid unnecessary losses. Reducing interest payments, stretching maturities, forgiving principal and taking other proactive action on loans (even loans that are current) can avoid problems in the future. Don't think a loan on the books is necessarily going to keep performing, just because the last payment has been made. Stress can be exacerbated and borrowers everywhere are feeling pain. When the wheels are falling off the industry, sometimes action must be taken to protect the franchise. Don't be shy about restructuring loans, asking for more collateral, asking for a larger deposit or even a pay down to do so. Not all borrowers are desperate, so now is a great time to try to expand relationships that make sense over the longer term.

If you feel like you are destined to break rocks forever, our suggestion is to lighten up. Nothing lasts forever, Australia is a great country and if you keep banging away at the biggest problems they too will eventually shatter.

BANK NEWS

3rd Bank Failure

On Friday, the CA Dept of Financial Institutions closed 1st Centennial Bank ($677mm, CA) and the FDIC was named Receiver. The 6 branches were acquired by First California Bank ($1.1B, CA), who agreed to pay a 5.29% premium for the insured deposits and 30. The cost to the FDIC fund is expected to be $227mm. Of note, there were 25 bank failures in 2008.

M&A

WesBanco Inc. ($5.12B, WV) has agreed to purchase 5 branches, including deposits and property, from Amtrust Bank ($16.5B, OH) for $20.9mm. WesBanco will not assume any loans as part of the deal.

TARP Tracking

The Treasury will be sending a letter to TARP recipients requesting information on the status of complying with the restrictions on executive compensation and a narrative on how the TARP funds will be utilized.

FHLB Seattle

The beleaguered Home Loan said, despite warnings that capital will likely fall below regulatory minimums, it has no immediate plans to raise more.

Appraisal Change

New guidelines issued by FNMA/FHLMC no longer allow mortgage brokers or realtors to choose appraisers, which will now be selected by lenders. The guidelines also do not allow lenders to withhold payments to appraisers or promise future work.

Citibank

On Friday, the bank sold over $12B in FDIC backed bonds. This is the largest TLGP debt offering to date.