OPPORTUNITY KNOCKS

by Steve Brown

Take a walk down any residential street in this great country of ours and you will see hundreds of sizes and shapes of door knockers attached to doors all over the place. While doorbells have largely replaced the knocker as a way to get occupant attention, they still look good and remain quite effective. In banking today, opportunity is also knocking, particularly if one knows where to look. Risk is high, however, so care must be taken.

As we all know, the entire banking system right now remains under stress. It cannot be stated enough that we are smack dab in the middle of a once-in-a-generation downturn. Loan losses are jumping and reserves are draining earnings performance. As such, banks need to tread carefully. In short, everyone is sitting at the window and peering outside, wondering whether they will soon get doorbell ditched. Every shadow is analyzed that might portend a bell-happy person with quick feet.

The tough thing right now for banks seeking to buy loans or figure out where the next loan problem will surface is virtually impossible. After all, while projections abound, does anyone truly know? Making any guess about where things go from here after such enormous stress (plus the impact of regulatory rule books that seem to be rewritten hourly) is highly likely to be wide the mark. Since we aren't known to be shy, however, we must at least try to narrow things down.

In April, Moody's predicted the default rate for corporate loans would probably hit 15% this year, which is over 300% higher than the level we were sitting at when the year ended in 2008. The problem that has the FRB losing sleep at night (as are many bankers we know), however, isn't the magnitude of the increase, but rather concern over recovery rates. Historically, commercial real estate has fetched about 71 cents on the dollar when a loan defaults and the bank moves to collect. That is because, historically speaking, commercial real estate values have held up well over time and investors like to own the stuff. The main worry for the FRB (and bankers everywhere for that matter), is that corporations have borrowed huge sums of money that need to be refinanced in the next few years, unemployment is rising and stresses continue. If that debt does not get refinanced easily, corporate bankruptcies could increase, pushing some analysts to project recovery rates on real estate loans as low as 40 cents on the dollar in some overbuilt markets. Instead of focusing on the negative, think about the opportunity.

Bankers have a real opportunity to take advantage of this potential issue. To begin, refinance the best borrowers into longer term fixed rate loans. This will stabilize debt service and ensure your sales teams have years to cross-sell the next 3 to 5 products. Do this and lock in longer-term customers for a longer period of time - even if markets recover faster than expected.

Next, bankers can widen out pricing. When stresses are evident, it does not mean necessarily it is time to press the doorbell and run. Instead, think about asking for upfront fees, widen the spread on the loan and force the corporation to move the payroll account to your bank before anything else. When fewer competitors are playing and conditions are weak, pricing loans to fit your parameters (and widening them to support the added risk) is an opportunity in the making.

Finally, don't get too concentrated in anything. Right now predictions are about as good as the weather person's, so carry an umbrella even when the sun is shining. Cut back on exposures to any single borrower and even if bad things happen, they won't get too ugly to handle.

No matter where this banking life takes you, remember that sometimes opportunity knocks loudly and sometimes it does not. Stay alert and opportunities will find you.

BANK NEWS

M&A

BCB Bancorp Inc ($598mm, NJ) has agreed to purchase Pamrapo Bancorp Inc ($592mm, NJ) for $26.5mm in stock.

M&A

National Bank & Trust Financial Group, Inc. ($529mm, OH) will acquire Community National Corp. ($99mm, OH) for approximately $6.8mm in cash and stock.

Liquidity

Federal regulators released proposed guidance to help banks with managing funding and liquidity. Little of this is new information, with most of the changes affecting larger banks as they struggle to comply with Basel II principals. The guidance can be found at (in a 60 day comment period): http://www.fdic.gov/news/news/press/2009/pr09107a.pdf

Not Yet

St. Louis FRB President Bullard (alternate voting member of FOMC) said monetary policy would remain "very accommodative for an extended period" in order to support economic recovery. He also indicated that once the FOMC decided to begin removing the flood of liquidity in the system, a possible sale of Fed-owned assets was probably likely in order to control inflation.

Mortgage Delinquencies

According to the OCC and OTS, 2Q saw 5% delinquencies in SFR, more than double last year.

Good News

Yale University economist Robert Shiller, of Case-Shiller home price index fame, said he saw a "striking improvement in the rate of decline" in home prices in Apr and that the market he so closely tracks is "predicting the declines are over."