YOU CAN WIN IN THIS MARKET

by Steve Brown

Sometimes we hear bankers say in desperation, "You just can't win in this market!" Well folks, we are here to tell you that you can. Our loan pricing model is immensely beneficial for community bank loan performance. How beneficial you might ask? We have updated our client performance statistics and are happy to report some very compelling numbers.

We took a look at customers that were actively utilizing the Loan Pricing Model for more than a year and had included results in their loan review processes. Given industry stresses, it is no surprise that all of these clients experienced an increase in noncurrent loans over this period, but here are some surprises:

- 67% increased ROE over the past year

- Average ROE improvement was 113%

- 75% improved their ROA

- Average ROA improvement was 119%

- 75% of these clients increased assets

By comparison, community bank peer group non-users experienced an ROE and ROA decrease of approximately 85%!

We readily admit there are millions of other factors going on when it comes to bank performance, but we found these numbers so compelling, we became intrigued with the customers who did not improve performance. Here were some other findings: All of these underperforming banks had a much higher than peer group exposure to construction lending and all had been significantly reducing their exposure to construction lending over the past year. In addition, 30% had significant concentration issues and 50% had significant funding challenges (higher than peer group average, with a higher than average percentage of funding coming from higher yielding CD's.

Our key takeaways are despite an increase in non-performing loans, most clients who used a sound risk-adjusted loan pricing discipline, closely monitored funding costs and were not concentrated were able to generate acceptable returns (It would be unrealistic in today's market to expect no losses). For the clients that did not improve performance, given their reduction to higher risk areas, we could make the case that the decline in their performance was mitigated by an appropriate reallocation of risk in their portfolio.

For those of you who still do not believe in the value of an unemotional risk-adjusted model for valuing loans to augment the experience of a strong lending team, we hope the success of these peers may serve to change your mind. Moving to a risk-adjusted loan pricing model not only helps banks target a desired return and manage risk, but it also helps improve portfolio management, training and client negotiations. Our Loan Pricing Model is updated monthly on multiple factors, so bankers stay on top of fast-developing trends and can more accurately monitor performance. This is important now more than ever, because lending risk can deteriorate as much as 20% over a quarter (such as the lending risk on industrial properties for 2Q). To find out how our Loan Pricing Model can help your bank achieve its loan profitability and risk goals, contact us and we show you how we can tilt the probability of winning in your favor.

BANK NEWS

M&A

KleinBank ($1.57B, MN) will purchase Community Bank Plymouth ($62.4mm, MN) for an undisclosed sum. Plymouth lost $2.3mm in the 1H of this year.

Mortgage Stress

Credit monitoring company Equifax reported a record 7.32% of people were at least 30 days delinquent on their mortgage in July. Meanwhile, Moody's projects 5mm people will lose their homes in the next 3Ys, even after the stimulus programs kick in.

Free Checking

Banks may find difficulty offering these accounts if restrictions on overdraft fees are instated. According to a Nov. 2008 study by the FDIC, overdraft fees account for nearly 75% of all deposit service charges, which comes to nearly $30B a year. The FRB proposed an overdraft opt-in or out option at the end of last year and congress has considered placing limits on overdraft charges.

Housing Study

A study by Fitch that covers $1.7T of mortgages found the "cure rate" of loans that slip into delinquency and then return to current payment status is worsening. On Prime loans, the cure rate fell to 6.6% in July (down from 45% average of a prior 6Y period); Alt-A loan cure rates fell to 4.3% (from 30.2%) and subprime loan cure rates fell to 5.3% (from 19.4%).

Off Balance Sheet

FASB decided in May to include Qualifying Special Purpose Entities on balance sheets beginning in 2010. However, federal regulators are considering postponing these requirements in view of the economy.

Foreclosure

The process now takes 18 months to 2Y compared to just 15 months a year ago. As of July, the percentage of homes 120 days past due rose to 2.5% however the percentage of homes repossessed remains at less that 1% as banks attempt to push back losses.

CA Value

For the first time in 76Ys, the assessed value of taxable real estate in CA dropped. It was down 2.4% and will have a direct impact on municipalities. San Francisco did the best and was one of the few positive counties (up 7.1%), while Riverside was the worst (-10.5%).