INVESTMENT ALTERNATIVES

by Steve Brown

As we attempted to reenact a scene from The Office on an unsuspecting coworker (where Jim puts Dwight's desk accessories in the lunch room vending machine, only to make Dwight pay for them to get them out), we noticed the money. It hurt to figure out that the return on a vending machine investment was almost double the return of an investment portfolio. Honestly, it's depressing to keep looking at bank investment portfolios where the return starts with the number 1. It is almost to the point where it is not worth the accounting, wasting time talking to brokers or having ALCO discussions given the low return. The investment portfolio should give the balance sheet liquidity and provide return (with credit and interest rate diversification). However, what happens if your problem is holding too much liquidity and more of your loans are sitting on floors? Should you really care if your fixed rate exposure is higher than normal?

Of course a bank needs to have an investment portfolio, but once you have liquidity covered, another alternative for idle funds is for your bank to consider purchasing a syndicated C&I loan from us. While not as liquid as a bond, these loans provide good liquidity given their size and typically have a short average life of around 1.6Ys. They provide banks a parking place for excess funds until local loan growth picks up as well. In addition, their floating rate nature also allows community banks to better match funding sources. The floating rate on these loans also provides a stable mark-to-market should interest rates rise or you need to shock the balance sheet up 400bp for asset-liability purposes.

Priced at an average of Libor + 2.50% (about Prime - 40bp), these credits are originated and managed by large banks, while Pacific Coast Bankers' Bank administers them for community banks. Instead of getting a 1.20% yield in a mortgage backed security, banks can earn 2.80% floating or purchase a loan with a 1Y 5.00% floor for example. While admittedly these loans will not and should not replace your local area origination, they do offer a nice alternative to shrinking, are C&I and cost very little to acquire or maintain. As a result, these loans tend to be roughly equivalent to the profitability of average quality loans on your own books right now.

As with any such strategy, there are also risks involved. For instance, banks that purchase these C&I loans vs. investment securities are trading interest rate and optionality (potential extension) risk for credit and liquidity risk. That said, the credit of these loans probably compares favorably to those already in your portfolio, given these companies are larger, the loans have increased market liquidity, borrowers have greater flexibility to national/global markets to raise money and nearly all have much lower geographic concentration, to name a few factors.

Another positive thing these C&I loans can do for a community bank is to allow the bank to gain greater diversification. We underwrite and carry names such as Altegrity (formally known as Kroll) that handles background checks for the government, Puget Energy (utility), PQ Corporation (chemicals), Flextronics (technology) and several healthcare names. These borrowers were chosen not only for their positive risk/return tradeoff, but also with a goal in mind to help community banks offset existing concentrations in commercial real estate.

We are not advocating building a bank around purchased credits, but do think it makes great sense to consider as an option to other alternatives or a way to quickly increase C&I totals yet maintain decent liquidity. Diversification is important and it helps produce earnings which allow you to remain focused on your core mission of serving your local customers.

Give us a call to review our offering list of these C&I loans and then consider purchasing a $1mm piece to see how it works and performs. Contact us to receive program information and an underwriting package on any credit you see. Somewhere about halfway between a generic community bank loan and an investment in liquidity and flexibility, these C&I loans provide an excellent alternative and a useful tool in building loan balances while diversifying risk. Now, excuse us as we help a coworker feed $1.25 into the vending machine to retrieve their stapler.

BANK NEWS

Branch/Customer Expansion

USAA, the first large bank to allow customers to scan pictures of checks into a Smartphone, has now teamed up with delivery company UPS Inc. to offer in-store check depositing services. UPS employees swipe a USAA customer debit or ATM card, scan a check and make a deposit right at the store. The move is an easy way for customers to make deposits without having to go into a USAA branch, as they do business at UPS/Mail Boxes Etc. stores.

Call Report Changes

Regulatory agencies have published a proposal to change the Call Report in 2011 to include further breakdowns of OREO covered by FDIC loss-sharing agreements by category; more detail around past-due and nonaccrual government-guaranteed loans; and revisions related to assets and liabilities whose interest rates have reached contractual ceilings or floors for purposes of reporting maturity and re-pricing data. The comment deadline is Nov. 29.