FORSEEING AN UNKIND CUT

by Steve Brown

Is it us or do Marcus Brutus and Elizabeth Warren bear a striking resemblance in this picture? Call us superstitious over the Ides of March, but we are not turning our back on anyone today. In honor of the soothsayer that tried to warn Caesar, we will look ahead to talk about the risks of commercial real estate (CRE) refinancing at community banks. The good news is that property values are starting to improve. Net operating income at multifamily, hospitality, industrial and even retail and office have registered positive growth recently. Capitalization rates are starting to come down and liquidity from investment funds and REITs are evident in nearly all things commercial. Even 60+ day delinquencies at community banks are starting to plateau in many areas. Unfortunately, we still have record volume to refinance, as 2011 is the start of a huge refinancing wave at banks that runs through 2013. In order to help you gauge potential risk, we have compiled some data that looks at the probability of refinancing, in order to help you spot issues before they arise. We looked at about 4k matured balloon loans and collected data on whether they were refinanced successfully without a loss or were paid off. For starters, the data found one of the largest determinants of probability of full repayment was the vintage or year of origination. If a loan was originated in 2004 or earlier, chances were good that there was sufficient LTV and cash flow to service the debt. From 2005 through 2008, property values ran up so the odds of a successful refinancing get increasingly worse with each subsequent year of origination. As a corollary, the older a loan was, the more likely it could be refinanced. While interesting, this isn't all that helpful and so we converted the data to probabilities. On an LTV basis, if a loan has a current LTV of 80% or greater, it has only a 22% chance of getting refinanced without incurring a loss. For loans below 80%, the probability jumps to 77%; loans below 60%, see a probability of 81% and for loans below 40%, the probability oddly is about the same as those loans below 60%, at 82%. On a DSC basis: loans at 1x coverage or lower have only about a 2% probability of getting refinanced without a loss; those around 1.2x have a 45% chance of getting refinanced without a loss; those at 1.4x have a 68% probability and those at 1.6x and above have about an 80% probability of refinancing without a loss. Since LTV and DSC are somewhat dependent, they are not additive (however they are supportive). While we don't have the space for all the permutations, we will throw out 2 important ones. As a midpoint, if a loan has an 80% LTV and 1.2x DSC, then it has about a 50% chance of getting refinanced without a loss. A loan with a 60% LTV and 1.4x coverage is highly probable for refinancing in this market with 91% odds. Next to LTV and DSC, loan size matters. Here loans between $350k and $1mm have the highest probability of refinancing, followed by loans between $1mm and $3mm. As loans get larger, the probability of refinancing gets smaller, due to fewer banks being able to fund the loan. However, it should also be pointed out that size, unlike LTV and DSC, isn't that sensitive, so the probability of a $10mm CRE loan getting refinanced is only 4% less than a $3mm loan getting refinanced. Finally, location matters. If the property is located in a major market such as S.F., L.A, Chicago, D.C., or New York for example, the odds of a successful refi or payoff is about 10% greater than properties located in smaller metro markets. Of note, however, the smaller metro market property is about 15% more likely for repayment than a property located in a tertiary market. Hopefully, this data helps banks see ahead, as they update their schedule of refinance / repayment risk. By planning ahead and devoting more marketing, credit and management resources to those loans with the lowest probability of getting repaid; maybe some of the odds can be overcome and help prevent the market playing Brutus.

BANK NEWS

Bank of America

Given limits on late charges and overdraft fees as part of new banking rules, BofA has notified about 5% of its credit card holders that a $59 annual fee will be imposed beginning April 11. The fees are reportedly being charged to those customers who would not qualify for a new account today and to help cover the additional risk.

Mobile RDC

US Bank has joined Chase and USAA in allowing customers through its Deposit Point Mobile service to deposit checks by photographing them with a cell camera.

Garnishment Rules

The Treasury has issued additional guidelines banks must follow when they receive a garnishment order against an account holder who receives certain types of federal benefit payments by direct deposit.