INFORMATION, BUT NOT OVERLOADED

by Steve Brown

Studies show you can lose as much as 25% of your day to information overload. That is why the experts say you should create a schedule of what you are going to do, every single day. This article isn't going to be about how to save time, but instead we provide some information on and around the banking industry that will be helpful without overloading things too much. As we await another report on GDP this Friday and some information from the Fed's annual meeting in Jackson Hole, we thought some perspective might be in order. We begin with the point that GDP measures the output of goods and services produced by labor and property in the US, so it is the final arbiter of growth. GDP came in at 0.4% in the 1Q and the estimate so far is about 1.3% for the 2Q. Only time will tell whether the 2Q number is close to the mark (recall the 1Q number swung from 1.8% to 0.4% when the final data printed), but many are worried. That means growth in the US and also in your loan portfolio can be expected to be somewhere around 0.4% to 1.3% for 2011. For now, to keep things simple, let's say that means the loan portfolio can grow at slightly less than 1%, based on underlying economic fundamentals. If you haven't done so already, you might want to consider revisiting your loan growth projections put in place at the beginning of the year, as you determine what impact this slower growth scenario will have on earnings and overall performance. Another area to think about (when you are strategizing what to do with the bank and where things will end up this year) has been driven by interest rates. On a year over year basis, interest rates have fallen 100bp (the 5Y and 10Y Treasury rates have fallen sharply). This has flattened the curve and will have a substantial impact on both current and future asset-liability positioning. Consider that the average community bank portfolio is chock full of optionality. Municipal bonds, callable agencies, MBS and CMOs are the primary types of securities held by community banks and all will see faster cashflow returned as rates fall. Roughly speaking, you can probably expect prepayments to accelerate 5% to 15%, with the pain of then having to reinvest cashflows at a rate 100bp below the coupons you are currently carrying in the portfolio. That erodes return (particularly when most securities in the portfolio are at a premium) and adds pressure to performance. On the loan front, lower longer maturity yields mean customers will want to refinance their loans and extend them further out the curve. Customers will therefore seek out more long-term fixed rate loans, in order to add predictability to their monthly costs, as they seek out ways to help their businesses. Many community banks will be reluctant to go long when the deck seems to be stacked toward higher rates over time, but competitive pressures will drive even further capitulation as fights erupt over the very best customers. At a minimum, you can expect some portion of the loan portfolio to refinance away and be lost to competition, given this sharp drop in rates and the corresponding change in borrower behavior, so prepare now. Finally, this confluence of events has resulted in added pressure on the bottom line. That will result in branch closures, targeted personnel layoffs (some of the big banks have already announced them), increased M&A activity and reversals of loan loss reserves to name a few options banks will be considering and executing upon. The issues from Dodd Frank that are just beginning to trickle through the industry and the stresses outlined here also mean bankers will need to remain nimble and efficient until things settle down. Let's hope the problems we face will move through quickly and the information can be processed without overloading banks more than has already occurred.

BANK NEWS

Closed (68): Lydian Private Bank

($1.7B, FL) was moved into receivership with Sabadell United Bank ($2.4B, FL) purchasing approximately 53% of the assets under loss share and most non-brokered deposits without premium. First Southern National Bank ($165mm, GA) was also closed with Heritage Bank of the South ($948mm, GA) assuming 75% of the assets under loss share and almost all deposits for a 1% premium. First Choice Bank ($141mm, IL) was closed with assets and all deposits (excluding brokered) assumed by Inland Bank & Trust ($1.2B, IL) without premium.

USPS

Banks are scrambling to determine their potential lease exposure to US Post Offices on their retail loans, as the agency is expected to reach its $15B borrowing limit next month. This is expected to force structural changes that include shutting down 100 of offices and stopping Saturday mail delivery.

Callables

While we gave an estimate last week, we now have the exact figures calculated - 94% of the callable agency market that can be called, will be called in the next 3 months.

Industry Tone

A PWC survey finds 90% of banking industry leaders say the "biggest threat to their growth prospects" is over regulation.

Slower Growth

Goldman Sachs lowered its GDP forecast for the US in 2011 to 1.5% (from 1.7%).

Rent or Buy

Trulia reports buying a home was cheaper than renting in 74% of the country's 50 largest cities in July.

Capital Sources

Analysis by Kafafian Group estimates only 18% of banks in the US are large enough to get access to private equity funding.

Mortgage Dominanace

The top 10 mortgage servicers control 90% of all originations and servicing in the US.