A JINGLE AND JANGLE IN BANKING

by Steve Brown

You have seen these people at periodic times in your life. We call them "Jinglers," because you can hear them coming a mile away. They attach keys to their belt, dangle them from a backpack, or attach them to a plastic thingamabob around their wrist. These people like to be heard well in advance of actually entering a given room and they enjoy the jingle jangle of walking around and hearing keys clank into each other as they go from point A to point B. Since we don't jingle or jangle, we can't really figure out why some people enjoy this (it seems the keys would continually break loose and get lost as you walk around), but we will say it is funny to watch the reaction from others as Jinglers walk by. The way things are today in banking, it can often feel as though you are getting banged around like a ring of keys on the backpack of the industry.

A quick review of the industry surfaces some interesting information you might want to hear coming a long way off. The good news is that banks are finally recovering from the worst economic downturn since the 1930s. Progress has been slow, but that is typically what happens when a country has to work through a financial deleveraging process. For banks, industry earnings have grown over the past eight quarters and the percent of noncurrent loans has declined for five quarters. Capital ratios have also reached record levels. Those are all positive trends.

That is the jingle, but we also cannot ignore the jangle of key issues that remain. Housing is still in the doldrums and prices continue to fall. These loans represent 33% of all loans sitting in bank portfolios across the industry, so that is a big problem. Until housing finds some sort of footing, weakness in bank equity prices will likely continue as well. Another concern relates to the fact that most of the improvement in industry earnings has resulted from reductions in loan loss provisions. This makes sense given the improving credit picture, but it cannot continue forever. Core earnings growth will be essential and remains a focus for all banks. One problem here is that domestic economic growth is only expected to be 1%, so that is about the pace you can grow the loan portfolio. Given that low interest rates have greatly increased the incentive for borrowers to prepay or refinance, cashflow coming in could overwhelm such tepid growth in the loan portfolio. In addition, low overall yields give bankers few options to choose from in the securities world. Until GDP reaches 2.5% or more, look for earnings to remain soft.

Many community banks are exposed to commercial real estate (CRE), so we cover that more specifically here. A few major issues bankers are facing are that CRE prices have fallen about 49% since 2Q 2007 and about 33% of all CRE in the country comes due and must be rolled over in the next 2Ys. Given a high existing exposure in the loan portfolio, community banks will need to closely monitor and proactively deal with maturing loans, as many will be underwater and have weak property cashflows (due to high vacancies and low rents). No matter how you slice it, investment CRE losses are of particular worry. Losses in this area could worsen over the next year or so and banks will have to be vigilant. Overall, one key to success in CRE going forward will be to get proactive right away with your best clients, restructure loans if needed and extend loan maturities further out the curve into fixed rates. That way, you have plenty of time to cross-sell them to improve customer profitability, borrowers are locked down for a long time and the loans have a lower probability of problems when rates eventually begin to rise (because their debt cost is fixed). Make sure you hedge these loans or match-fund them to avoid problems. As for the good news in CRE, REITS and institutional investors seeking yield have ramped up and are very active buyers. They have raised billions of dollars that need to be deployed into the sector, so this should support capitalization rates, which have rebounded slightly (declined) as of late and seem to suggest investor expectations for price appreciation are increasing.

As you keep your ear tuned to the jingle of the industry, weÃ¢Â€Â™ll keep working to make sure you stay informed about major trends, so you have more time to react.

BANK NEWS

Relationship Profitability

In an effort to retain and grow customer value, Bank of America is rolling out extra perks for about 60k of its most profitable relationships in NC. In addition to solid marketing, the "Platinum Privileges" program gives customers access to VIP-level customer service, preferred pricing on products such as retirement accounts and fee waivers. Initial tests showed that the perk package increased balances, jumped cross-sell and raised satisfaction. Eligible customers will receive "welcome packets" in the mail as well as a call from the bank. BofA will expand the program to 8 states in Nov and take the program nationwide by mid-next year.

US Housing

A WSJ article tells "home forecast calls for more pain" and forecasts home prices down 2.5% this year and to increase just 1.1% annually through 2015.

Pre-emption

The US District Court ruled on U.S. Bank v. Schipper that the Nat'l Bank Act and OCC pre-empt state payment processing rules and Dodd-Frank made no material changes to pre-emption standards. The case involved an IA law that requires state banks to use state-approved "central routing units" to authorize foreign ATM transactions. US Bank argued that it was able to provide such service through non-state approved units just fine under Federal law.