C&I

by Steve Brown

Most banks are attempting to originate quality credits to increase loan-to-deposit ratios to bolster profitability. The emphasis by most banks in the market is on the C&I loan category. For diversification reasons and regulatory pressures, banks have been especially focused on this category for the last two years. There are a number of advantages for banks in booking C&I loans versus other categories, but we see four distinct advantages; 1) C&I relationships typically come with higher value deposits (less interest rate sensitivity), making the relationship more profitable through deposit and cash management cross- sells. 2) Borrowers can be identified that are counter-cyclical to real estate markets. Most community banks are heavily real estate focused, and identifying a countercyclical industry to real estate (such as a mortgage foreclosure company) has substantial benefits. 3) The average C&I credit has historically better repayment performance than real estate credit, primarily because, on average, C&I credits are less leveraged than the real estate credits (typically by a factor of 25 to 50% of debt-to- cash flow). Also, C&I business models show more operational flexibility than real estate credits. For example, it is very difficult to decrease overhead or cut operating expenses on a property when revenue decreases, but typically it is feasible for many manufacturing, distribution and services companies. 4) C&I loans are more difficult to underwrite and retain because of their complexity (banks can't simply multiply the appraised value by 75% to arrive at an advance rate). More complexity eliminates competition and increases return. Because of the above, C&I loans have held appeal for many banks. However, in today's market we are seeing distinct changes in the competitive landscape. Many national and super regional banks are hyper-competitive for C&I credits. In fact, they are hyper-competitive down to very small loan sizes - something that we have not seen before. While in 2006 and 2007 we witnessed BB&T, BoA and JPMorgan capture C&I business at spreads of 175bps over LIBOR, they are now quoting at about the same loan spreads for C&I credits that are only $100k to $500k in size (and tighter spreads for larger transactions). Their efforts are paying off, as the above graph shows, C&I loan volumes at the top 25 largest banks in the country has been growing at 10.5% pa since middle of 2010. This loan volume is coming at the expense of community banks where C&I loan volumes are shrinking. Add to this the lack of general loan demand, regulatory pressures on small banks plus ultra-low short term rates and the profitability picture is a clear challenge. We have been working with community banks to help bankers structure loans, sell participations, hedge rates, price based on a risk-adjusted ROE for the relationship and, lastly, understand the national C&I credits that we have available for sale. While underwriting C&I credits may be more difficult than underwriting CRE loans, there are resources available to help community banks compete. We have been training underwriters to properly analyze cash flow, stress test sensitivity to revenue and cost changes, and assess competitive pressures (Porters Five force analysis). We have developed policy guidelines and an underwriting white paper to help our bank's better understand national C&I credits. If you would like to receive a copy of our white paper or sample C&I policy, please let us know (we can email a copy without charge) by following the link to register in our related links section on the right. Lastly, if your underwriters are stuck analyzing complex credits through one of our programs, we can schedule a conference call with one of our seasoned underwriters. We can assist your bank in getting a jump on 2012 earnings, as well as helping you better compete against the big banks - we are just a phone call away.

Related Links:
[White Paper / Sample C&I Policy Registration]
[Bank Performance Presentation Registration]

BANK NEWS

3Q Bank Performance

3Q FDIC data is out and instead of running the details in the BID, we have put together a separate presentation on bank performance. If you would like to receive the slide deck to use in board, shareholder or community presentations, please register and we will send it out to you (see Related Links section below).

Biggest Bankruptcy

Jefferson County, Alabama filed for bankruptcy in the largest municipal bankruptcy in history, after defaulting on $3.1B of debt.

Foreclosures

Foreclosure filings came in +7% compared to last month and down 31% over the same period last year.

Biz Tax

The left-leaning advocacy group, Citizens for Tax Justice, released a study of the largest 280 corporations faced an effective tax rate of just 18.5% over the last 3Ys. That said, the study included tax carry forwards and did not include deferred taxes.

Morgan Keegan

Regions is reported to be reentering talks with Stifel Financial for sale of Region's Morgan Keegan unit after negotiations with private equity firms hit an impasse. Know any intellectually sharp Morgan Keegan brokers that are highly ethical and understand banks? Please send them our way, as we are interested in talking.