

GETTING CREDIT STRONGER

by [Steve Brown](#)

As we monitor commercial real estate loan cash flow in over 140 markets nationwide, we are happy to report that barring another credit shock, CRE cash flow and prices look poised to hit bottom by 4Q of this year. At this point, it appears about 51% of the markets either shows an increase in net prices or at least 3 quarters of stability. Of course, as the markets heal, higher rates are expected - a trend that we have seen strongly in some markets very recently. The bottoming of CRE prices and rising rates means banks have a small window to ensure maximum flexibility in stabilizing credit.

One strategy that we don't see banks using enough is taking qualifying loans that fail a credit stress test for higher rates (because of either cash flow coverage and/or their floating rate nature) and mitigating that risk through the SBA. Recent revisions to the SBA's 504 program allow banks more flexibility to bring owner-occupied CRE loans back into compliance. This allows small businesses to refinance existing real estate debt or debt on other capital assets, for up to a 90% LTV & extend amortization to 20Ys (helping cash flow, risk & profitability).

Loans under the 504 refinancing program are structured like traditional 504's, where the bank provides up to 50% of the value and holds the first lien position. A Certified Development Company (CDC) provides up to 40% of the value and takes a secondary position to the bank loan. The borrower then either must have at least 10% existing equity in the property or inject equity to that level. The big plus is that there are virtually no restrictions on the bank's loan with respect to structure (but maturities should be 7Ys on equipment and 10Ys on real estate) or pricing. Utilizing the CDC gives banks more ways to extract value (through pricing and/or risk mitigation) to increase the risk-adjusted profitability of the loan. While there is no maximum size for the loan, the 504 is limited to \$5mm (just like a traditional 504). It should be noted that the limit increases to \$5.5mm for certain eligible manufacturing projects and those that incorporate energy saving technologies (a plus for banks in this market).

Other items that banks need to know to take advantage of this is that the business must be for-profit, have a tangible net worth of less than \$15mm and an after tax profit of less than \$5mm for the previous 2Ys. The business must occupy at least 51% of the property at the time of the refinance application and the property must have been acquired at least 2Ys ago with debt. Existing government-guaranteed loans are not eligible to be refinanced, nor are expansion projects (however there is an option for refinancing under a modified version). Multiple refinancing of the original note will not disqualify the project and borrowers must show their loan is current with all required payments in the last 12 months (with any modifications taking place prior to 11/12/11).

We can assist your bank in understanding this better and stand at the ready to help. Using our Credit Stress Analyzer, you can help identify loans that might be suited for the program and leveraging our BLP program you can lock the fixed rate in for the borrower (while giving your bank a floating rate obligation). If you have already identified loans to fit the program, we can give you some tips on qualification and structuring. This program expires Sep 27 and rates are moving ahead of CRE property values, so banks have a limited time to identify and move potentially at-risk projects to better profitability. By utilizing this tactic, banks can provide superior customer service, while reducing capital at risk - a combination that can only serve to make you stronger.

BANK NEWS

Rates

Richmond Fed President Jeff Lacker (voting) made some hawkish remarks yesterday and said Fed will likely need to hike rates in 2013.

Freaky

As the new iPad hits retailers today, it is interesting to note the market cap of Apple at about \$550B has surpassed the market cap of the entire retail sector that will sell it (including WalMart, Target and all others combined).

Here is Here

Watch out banks - PayPal has launched a new product targeting small business customers called "PayPal Here." The service allows small businesses to swipe cards to accept payments from mobile devices; use the phone's camera to accept card or check payments and invoice from mobile applications, all for a 2.7% transaction fee for debit and credit cards (no fee for accepting checks).

Deposit Flows

The Investment Company Institute reports investors withdrew \$134.5B from mutual funds investing mainly in U.S. equities in 2011, marking the 5th straight year of net outflows (totals \$469B).

Put Backs

Analysis finds FNMA and FHLMC asked large U.S. banks to buy back \$33B in loans during 2011, up 10% over 2010. The GSE's can force banks to repurchase loans that have faulty appraisals or other defects, but banks say they are being forced to take back loans that default due to reasons unrelated to underwriting, such as when a borrower loses their job or that default after a longer period of timely payments.

BB&T

The bank is offering a series of free educational webinars targeted at helping small business owners protect their businesses from payment security issues.

Tech Banking

The head of internet and mobile banking for Citigroup said in a recent interview that Citi sees people using the internet/mobile channel to pay bills primarily, while using the tablet to make some payments, but also read educational content and get more interactive.

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