LOAN REPORTING

by Steve Brown

While we all remember Christopher Columbus as an intrepid explorer, few realize his analytical nature and ability for quantitative analysis. Columbus kept records of everything from the abilities of his men, to the tides, to his thoughts. More important than keeping records, he used them to further his goals and to manage risk. After having recorded the stability and floatation of a particular ship, with an impending storm approaching, he instructed his men to throw food and fuel provisions overboard to lighten the load and create more buoyancy. His men thought he was crazy, but his ship survived, which was better than 3 other boats in his 7 ship flotilla. In the West Indies, after several months of being stranded and with relationships breaking down with the indigenous people, his men faced starvation. After consulting his notes and records he came up with a plan. He gathered the chiefs of the local tribes on the Island of Jamaica on Feb. 29th, 1504 and told them if they didn't help with food and provisions that God would punish them. As proof, God was planning to turn the moon red as a final warning sign. Sure enough at just before midnight, the Moon turned red and the chiefs couldn't have been more helpful thereafter. Good thing Columbus was smart enough to forecast a lunar eclipse. In similar manor, good loan portfolio reports are critical to forecasting events. Banks spend a tremendous amount of time underwriting loans, but may not put in the time to keep accurate records after that, or if they do, consult them to help guide future decisions. Ironically, banks spend little time setting allocations and understanding portfolio level risk compared to underwriting individual loans. Yet, strong portfolio management is more often a competitive advantage compared to loan underwriting. We have reviewed analysis from some of the best risk management minds in finance to come up with a list of concentration report stratifications that banks should consider. Most banks understand the importance of getting a portfolio breakdown by credit grade, loan type, geography, borrower (and related party) and NAICS code. This is all good as it is descriptive, but it may not be that helpful for risk management. For example, in terms of credit risk (which dwarfs all others), single family and commercial real estate are about 89% correlated in most parts of the country. Thus, having a well balanced portfolio between the two is nice, but it also gives a false sense of security. Having a breakdown between non- correlated categories (such as real estate vs. consumer), would be more helpful. The same goes for geography. What you really want to know is the breakdown of loans in geographies that are not correlated. Making customized geographic areas with groups of counties, metro statistical areas or zip codes is more effective. Many banks also overlook a vintage report by year of loan origination. While not terribly helpful by itself, at times (like from 2004 to 2008), it is advantageous as a proxy for loan values. In 2008, banks that quickly put resources to work monitoring and managing their 2006 loan production were more successful than banks that waited for problems to arise before reacting. The other major report that many banks overlook is one that shows both maturity date (to look at roll over risk) and likelihood of prepay (taking into account prepayment and yield maintenance provisions). This report has proven especially helpful recently, as loans that do not have prepay protection have strong cash flow. They also have an approximate 30% probability of prepay (depending on the size, performance and area of the country). Many banks would love to know this to better manage the customer relationship and profitability. Other popular reports include owner occupied vs. investor owned real estate, cash flow coverage buckets, loans on floors or with caps, those that have previously migrated, past TDRs, probabilities of default and origination/underwriting team (for acquisitive banks or multi-bank entities). The goal with reports is to provide the management team with tools to ascertain ongoing credit, interest rate or prepayment risk. We will help further with this effort, at our EMC Conference coming up on May 20th where we will be discussing it in more detail. If you can't make it, be sure to pull a Columbus on your troops to get them to produce more helpful reports. By the way, the next solar eclipse in the U.S. is May 20th.

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BANK NEWS

Small Business Borrowing

A recent survey of small businesses find that 57% of companies believe bank credit is the same as last year, while 21% think it is easier and 23% think it is more restrictive.

Small Business Concerns

Regarding their own company, the top concerns of SBA companies are (in order): maintaining margins, cost of health care, ability to forecast results accurately, attracting/retaining qualified employees, obtaining capital, maintaining productivity, reducing debt and managing IT systems.

CU Closed

The NCUA closed Shepherd Federal CU (NC) a small $700k total asset credit union with 1,400 members.

Name Change

BankAtlantic ($3.7B, FL) will change its name to BBX Capital after a rocky acquisition road by BB&T.