# SPRINGTIME IN BANKING

by Steve Brown

According to the Almanac, spring officially kicked off Mar. 20, but it seems only now that the weather is generally warmer, flowers are blooming and business advertising has made the switch. Maybe it is just taking us all longer to emerge from our winter dens or maybe bankers have better things to do than to worry about what season it is from moment to moment. Whatever your reason, get out and take a walk at lunchtime if you can, as you enjoy decent weather in most parts of the country. Find a nice park with a soft spot of grass and lie down as you read a good book and drink in the sights and sounds as you relax. Reducing stress is usually easy this time of year and once you get thinking about something nice, you can take it back to the office for the 2nd half of the day. As we thought about spring and the growth that it brings, we thought about potential opportunities in lending. Many bankers are still struggling to find acceptable loans, as low interest rates and too much cash on hand have many bank competitors willing to extend credit at seemingly ever-lower levels. Five year loans to quality operators have dipped below 4% in some markets and competition is fierce. To get the debt coverage ratio to acceptable levels by lowering the periodic loan payments, some have extended amortization periods. Still others have played with structure to try and get things to work, offering a variety so colorful it looks like a meadow right now filled with bright flowers. No matter which of the above seems to ring true for your bank or your competition, consistency and quality in underwriting are critical to ensure long term performance. Underwriting practices can vary from bank to bank, but at a high level, they are the criteria bankers use to qualify borrowers; price loans; determine sources of repayment; understand collateral requirements; incorporate repayment terms; manage the loan portfolio; and manage concentrations and risks. To be truly successful, a strong underwriting process is based on tireless practice, consistency, checks and balances. Key risk areas where loan underwriting and risk management can get out of round occur when the bank makes larger loans that result in a concentration (can be by borrower or by industry/sector); lends into a sector where bank personnel have little or no experience; does out of market lending with little knowledge of the risks of the area; fails to adjust loan pricing to handle changing risk; doesn't take into account "what if" scenarios in advance and set contingency plans; and, originates loans outside policies. Each of these areas can get a bank into trouble, just as a cold chill can do great harm to spring flowers. There are many things you can do to structure a loan, but when interest rates are at some of their lowest levels in history it makes sense to protect against upward movement. Model new loan structures against your interest rate risk before you do too many of any type of loan and make sure the structure will do what you expect. Floating rate loans may sound very good when rates are low, but they can also blow up debt service coverage for the borrower and lead to unexpected credit losses if they move too far too fast. In the alternative, fixed rate lending without thinking about potential repercussions of higher rates at a balloon maturity or allowing a customer to prepay their loan based on the loan documentation default options of 10% to 20% per year without penalty can also be damaging. Know what you are getting into before you start, model it, stress test it and then discuss the benefits/risks before you begin planting seeds around the meadow. To make sure you get bright, colorful flowers and cool green grass without the weeds, you must proactively and consistently tend to your underwriting as you manage the garden. Enjoy the weather.

**Related Links:**

PCBB 2012 Executive Mangement Conference

# BANK NEWS

**Closure (16)**

Fidelity Bank ($818mm, MI) was closed and the liabilities and assets were purchased by Huntington National Bank ($54.2B,OH) under FDIC loss share.

**Ridiculous and Scary (Part 2)**

As a follow up on a story we ran last week, we are happy to report that the GA bill that would not allow 3rd parties that purchase recourse loans on property at a discount to go after a defaulted borrower for the full amount of the loan was struck down. Unfortunately, the law is the reality in some states such as NV.

**Breach**

Global Payments reported a major breach in their credit card processing, as hackers stole information on approx. 1.5mm accounts. After the breach, Visa, in a rare move, removed the Company from the list of "compliant providers."

**Mortgages**

The OCC reports mortgage delinquencies remained elevated but declined from a year earlier. Mortgages that were 30 to 59 days delinquent were 3% of the total serviced portfolio at year-end and those seriously delinquent were 5% of the total portfolio. Completed foreclosures increased 2.5% from the previous quarter and 22.1% from a year ago. The number of new foreclosures initiated during the quarter decreased 16% from the previous quarter and the inventory of foreclosures in process declined 4.1%.

**Loan Documents**

An ABA survey of bankers finds 45% of banks scan or image their loan documentation for investor delivery, compared to 55% that do not. For those who have not taken the step to do so, this could be an area to add efficiency, as you also save time and money.

**Bernanke Worries**

Fed Chair Bernanke said there isn't unlimited demand for US Treasuries from investors, which is interesting when you also consider the Fed bought about 61% of total net issuance in 2011. As the Fed works hard to keep rates low, investors worry yields could jump unless Congress reduces the deficit soon.