THE THREAT TO BANK LOAN PRODUCTION

by Steve Brown

We have a team in one of our favorite cities today, Nashville. We are meeting banks, reviewing loan performance and researching the deposit market. We have also learned of a colorful local, William Walker, who was born (1824) and holds the dubious distinction of being Nashville's only head of state. The story of William Walker is an interesting one for banks, as Walker made his career going into Latin American countries that did not have strong leadership, promoting a vision, gathering troops and then defeating the locals. Walker had a modicum of success controlling Lower California, Sonora and then pushing into Nicaragua, where he won a series of battles and ultimately became President. The problem was that his vision was built on "Americanizing" the area, installing slavery and self-enrichment. While strong at marketing, Walker fell short in long-term organization and proceeded to get his butt kicked by the focused armies of Costa Rica, Salvador, Guatemala and ultimately Honduras (which summarily executed him for being such a pain). The story is interesting, as it highlights a trend that we see in a variety of banking markets. Nashville is a good example, because of the battle going on for commercial loans. What is taking place here is a trend that we are seeing in cities across America. Banks are facing adversaries similar to Walker that come in from out of town, market a short- term vision and reap the rewards. Specifically, in multifamily lending, FNMA & FHLMC control almost 70% of the market. In CRE, the life insurance companies and securitization conduits control a material amount of the market (an est. 30%). In both cases, these entities come in with a plan banks need to know. First, each of these groups targets brokers and non-bank finance companies to promote their products. Second, they offer a long term (10Y or more) fixed rate loan (average 10Y rate in Nashville is now 4.7%). Third, the fixed rate loan is usually at an aggressive margin. Fourth, in many cases recourse is not required. Fifth, in 10% of the life insurance cases and 20% of the conduit cases, loans will go up to 80% LTV. Finally, they offer a 3-4 week turnaround time promoted as quicker than what you get at a bank. If there is one other thing to add, it would be that each has a strategic plan that calls for adding more loan growth in the 2012 and 2013 vintage because of favorable economics (and because of the large amount of refinancing coming due from the 2003 to 2007 growth period). Many banks unfortunately are still targeting a specific margin instead of profitable relationships. That lets some quality loans slip away. A higher emphasis is placed on LTV and recourse than cashflow, giving life companies and conduits an advantage. We hasten to add that despite higher LTVs and lack of recourse, CRE from life companies in many cases have performed better than banks, while the securitization conduits have performed about the same. What happens in markets such as Nashville is that a focus on margin leads to adverse selection (as weaker cash flowing properties can't qualify for other programs and then have no other choice than to add guarantees and lower leverage). Please don't misunderstand us though, as guarantees and LTV are important (just not as important as a good location, solid cash flows and/or pricing). We highlight these factors to underscore how banks can better compete. We are not saying you should weaken underwriting standards, but we are advocating focusing on the items that truly matter. Turn a fixed rate loan into a floating rate loan through our BLP Program or through a hedge, offer a fast turnaround time and require a core operating account to make up for any price issues. Depending on your outlook for the economy, it can be argued that this is the perfect market to add loan volume. Regardless, of what you choose, we implore you to make a proactive choice on how you compete instead of letting transaction oriented "filibusters" come into your market and make the choice for you. It is still a competitive market and community banks are in a great place to win the battle.

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BANK NEWS

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Teaching Children

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DIF

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IB Job Cuts

Wall Street firms will reportedly begin reducing investment banking staffs as they struggle to boost profitability and M&A activity remains tepid. Dealogic reports that as of the 1Q of 2012, global M&A revenue fell to $3.8B, about 17% below the same period in 2011 and the lowest quarterly revenue total since the 1Q 2010.

Small Business

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