# LOOKING FOR LOANS WITH BEN FRANKLIN

by Steve Brown

You may not know it, but Ben Franklin loved the water. He grew up in Boston, was drawn to the sea and often dreamed of becoming a sailor. As Americans, we are all grateful that he changed his mind on going out to sea, but that background is what drove him to learn to swim. Further, because of his inventive mind, Franklin is credited with inventing swim paddles that fit onto ones hands. The paddles were shaped like lily pads and were roughly 10 inches long and 6 inches wide, according to Franklin's own writings. They not only helped him swim faster, but updated styles have been used for years by swimmers training for the Olympics and other big swim races. Sometimes you have to look far and wide for ingenuity and sometimes it is right in front of you. Long live inventors and their creativity. Given that Halloween is right around the corner, maybe it is time to break out the Ben Franklin mask at your party. Speaking of parties, have you ever shown up to one at the right time, but at the wrong venue? It is a disappointing feeling because you know there is a fantastic event somewhere nearby, but here you are all alone, wearing fancy jeans, a shiny shirt and you can't figure out how to get to the right location. We see this same occurrence in the community banking world related to lending activity. The common notion in the market today is that loan demand is soft. We sympathize with this, as loans are the only way for a bank to achieve meaningful performance, when considering the meager yield in securities. There is a massive lending party going on, however and all you have to do is figure out how to get there. Contrary to popular belief, loan demand is robust, as borrowers are looking to lock in term while rates are at historical lows. The yield curve is flat and presents attractive financing opportunities, as 20Y rates are only about 175bp greater than 5Y rates. Long-term fixed-rate lending is at fundamental odds though with a community bank's asset/liability structure. Those that add significant duration on the asset side of the balance sheet are setting themselves up for substantial pain as rates rise in the future and funding costs follow. So, how do we tap into this loan demand without taking undue risk? The short answer is to do so through interest rate swaps, since banks are compensated mostly for taking credit risk in the loan portfolio and not interest rate risk. An interest rate swap gives the borrower a fixed rate loan (stabilizing cash flow) while the bank enjoys a variable rate (better matching funding sources). While the underlying benefit of loan hedging lies in mitigating interest rate risk, the real victory comes in the form of increased loan demand. Banks can offer what business customers are specifically seeking, so instead of being absent from the party, you become the life of the party. Moreover, long-term fixed-rate structures are attractive to stronger credit profiles, such as professionals looking to finance the building in which they operate. As an example, we have assisted banks in offering borrowers 10Y fixed rates below 4.00%, while the bank enjoys a variable rate in the neighborhood of 1M Libor + 2.00%. Certainly, spreads are tight for strong credits, but once captured, they offer additional cross sell opportunities and can support loan growth. We work with banks across the country to offer a hedging solution that eliminates the derivative from your balance sheet. We have also seen clients develop campaigns around fixed-rate lending and win meaningful market share from big banks. So, the next time you go out in your local market looking for loans and wonder where everyone is, make sure you have the right tools to uncover the best opportunities. Contact us and we would be happy to not only help you find the party, but do so with or without your Ben Franklin mask or swim paddles.

## BANK NEWS

**M&A**

Heartland Financial ($4.4B, IA) will buy Heritage Bank ($107mm, AZ) for $16mm in cash or about 1.24x book.

**3Q Earnings**

JPMorgan Chase reported 3Q profit of $5.7B (up 34% YOY), as revenues climbed 6% vs. 2011. JP reported strength in mortgages as it originated $47B of new loans (up 29% YOY); credit card sales (up 11%); mortgage revenue shot up 74%; retail banking climbed 21%; NIM fell 23bp to 2.43% (about 9%): and set aside about 25% less in reserves. Wells Fargo reported 3Q profit of $4.94B (up 22% YOY), as revenue and mortgage income increased. Wells reported earnings of 88 cents per share (up from 72 cents YOY); originated $139B in mortgages (vs. $131B in 2Q); mortgage banking noninterest income jumped 53% YOY; NIM fell 18bp to 3.66% (about 5% YOY); and set aside 12% less in provisions ($1.59B).

**Crazy**

Reuters reports 1 in 6 employees at Bank of America work to service problem loans.

**Customer Usage**

A new survey by the ABA finds 39% of bank customers prefer internet banking to any other method vs. 36% in 2010. Meanwhile, mobile banking is now preferred by 6% of customers vs. 3% in 2010. Rounding things out were branches at 18%, ATMs at 12% and using the phone at 9%.

**Cyber Attack**

Capital One is the latest major U.S. bank to experience a denial of service attack, as Middle Eastern hackers continued to take credit and announce more banks would be impacted.

**European Mess**

Treasury Secretary Geithner said problems in Europe will take "years and years" to correct themselves, as the region goes through a very challenging period to fix its economic issues.