TINKERING WITH TECHNOLOGY & THE BIZ MODEL

by Steve Brown

If you love getting or giving technology gadgets for gifts during the holiday season, you are bound to enjoy the list pulled together by the editors at CNET. They evaluated hundreds of technology items and boiled all of that down to their list of favorites. So, if you have friends or family that love to have the latest and greatest technology, here are the top of the top from the CNET list: Samsung Galaxy S3 smartphone; Sony Cyber-shot DSC- HX200V camera; Samsung SyncMaster monitor; HP Officejet Pro 8600 and the iPhone 5. New technology can be fun and it is certainly interesting to tinker with, so at least try to have fun as you figure out how the new gadget works. Along the same lines, banks are tinkering with their business model, as they try to figure out how to make money in a new industry. Things have changed and the regulatory burden, low rates, low loan demand and a lack of options are all placing increased burden on community banks right now. That has pushed some to shrink their balance sheet, look for ways to cut costs and look under every stone for new sources of revenue. It simply costs more to do business now than it ever has, as regulations have forced banks to hold more capital and liquidity. Add to all of these issues an aging customer base and a sharp shift in customer behavior to online banking vs. branch usage (and a shift in payments to non-bank internet companies) and it is easy to see why so many banks are struggling right now. Using FDIC data as of the 2Q, we find the industry produced an 8.86% ROE. That is low, historically speaking, but when you drill down to banks under $100mm it drops even further to 6.79% (for banks $100mm to $1B it is 8.30%). Unfortunately, as the data show, it is particularly difficult for community bankers right now to generate a strong ROE. Low interest rates are impacting community bank performance, because so much of that performance is attributable to interest income earned between the cost of deposits and the investment options available on the asset side (net of loan losses). Compounding this issue, non-interest income options are limited given the regulatory environment. Finally, this all comes amidst the greatest change to the regulatory rule books in our history - much of which is still yet to be written (50% of Dodd Frank, Basel III, etc.). These are all key reasons why community bankers right now are tinkering with their business models. Simply put, to raise capital, it takes a return of around 12%. When you model what it takes to get there in this environment, it becomes obvious things will have to change. As indicated above, bankers are attacking this problem using multiple methods, but those we see most often include: getting more efficient (closing branches, streamlining operations, pushing customers to online and mobile channels, improving technology, pricing by relationship, etc.); shrinking the bank (so less capital is needed); and seeking out new revenue streams (moving into single family residential lending, expanding C&I, buying longer-term securities, etc.). Clearly, each of these strategies has its own risks and potential rewards, but they all show how important it is right now for community bank management teams to be actively moving forward with strategies. The industry isn't going to change back to the way things used to be, competition is fierce and regulation is choking performance. To hit an acceptable return for investors, tinkering with new things and reengineering existing ones to make them better is simply part of the banking landscape now. Keep trying every day, keep thinking about new things that could make a difference and enjoy every single moment because you are living banking history right now. Times are tough, but the community bankers we know are much, much tougher.

BANK NEWS

GDP Forecast

The OECD is projecting global GDP will slip from 2.2% forecast 6 months ago to 1.4% for 2013, as the impact of the fiscal cliff and issues in Europe negatively impact the world. Meanwhile, U.S. GDP is projected at 2.0% next year.

TAG

Senate Majority Leader Reid has introduced a bill that would extend TAG for two more years through 2014.

GDP Boost

Bloomberg estimates Hurricane Sandy recovery spending could be $140B to $240B in 2013, adding up to 0.5% to GDP growth. Of note, JPMorgan is currently projecting GDP will be 2.0% in 4Q 2012, then 1.0%, 1.5%, 2.5% and 3.0% for each quarter in 2013 (1.7% average in 2013).

Best & Worst Occupancy

The Census Bureau has released a report that finds as of the end of 2011 (the most recent period available), major metropolitan areas with the lowest/best occupancy rates for houses, apartments and condominiums were: San Jose-Sunnyvale-Santa Clara, CA (4.3%); Lancaster, PA (5.6%); Minneapolis-St. Paul-Bloomington, WI (5.7%); Oxnard-Thousand Oaks-Ventura, CA (6.0%) and Portland- Vancouver-Hillsboro, OR/WA (6.2%). Meanwhile, those with the highest/worst occupancy rates in order were: Cape Coral-Fort Myers, FL (35.9%); Wilmington, NC (26.6%); Deltona-Daytona Beach-Omond Beach, FL (25.5%); Port St. Lucie, FL (24.0%) and North Port-Bradenton-Sarasota, FL (23.6%).

Dodd Frank Update

The latest analysis finds that after nearly 2.5Ys: 33% of DFA rules have been finalized; 28% are proposed but past their deadline; 8% are not proposed and are past their deadline; 25% have not yet been proposed and have a future deadline; and 6% have been proposed and have a future deadline. The data shows lots of work remains and the impact to community banks will be felt well into the future.

Ongoing Risk

Showing how ugly things are abroad, analysts now say Italy will need a bailout in 2013.