Sneezing At Loan Concentrations

by Steve Brown

WebMD reports 20% of people in the US have allergy or asthma symptoms of one sort or another. Still, that is low compared to the 55% who test positive to one or more allergens. Interestingly, 15% of people believe they have a food allergy, while only about 4% actually do. We surface this because it is no sneezing matter that adults miss 5 days of work each year on average due to issues with asthma/allergies. Speaking of things that are nothing to sneeze at, today we explore loan concentrations at community banks.

Bank loans have been growing at a rapid clip lately. Through the end of 2016, net loan balances for insured financial institutions grew 5.3%, according to recent reports from the FDIC. Unfortunately for community banks with assets less than $1B, the same data shows that for this group YOY loan balances actually decreased 0.8% over the same period.

While loan growth is well off the peak of the overheated economy in 2008, the pace is still strong enough for regulators to begin worrying about the impacts of that growth. What regulators see is a few select areas where they notice increasing loan concentrations start to bubble up. Banks that become more concentrated in certain loan areas tend to face greater loan loss risks, as was well analyzed and documented following the credit crisis (what regulators affectionately refer to as "lessons learned").

As it happens, the three areas highlighted by the FDIC are all important loan categories for many community banks: commercial real estate (CRE), agriculture (Ag) and oil and gas (O&G). CRE loan concentration has been bumping up in community bank loan portfolios across the country. On the other hand, Ag lending and O&G lending concentrations have tended to be centered in certain geographic regions tied to those businesses.

In its winter edition of Supervisory Insights, the FDIC delves into the credit risk issues facing banks that are seeing increased loan concentrations in one or more of those three categories.

Banks that have some loan concentration are not necessarily facing higher risks however, the FDIC says. Further, it notes that community banks can experience higher concentrations in certain categories as an ongoing part of their businesses. But, rising concentrations should be closely monitored, as the potential for problems can increase as concentration levels rise.

Without reasonable diversification, risk management programs may require extra oversight. The FDIC says banks with too much concentration may need to enhance procedures and policies for credit and liquidity management, as well as for loan review. Bankers may need to increase allowances for loan and lease losses as well and could even need higher capital levels. Although this is not news for community bankers, now is a good time to start planning to make sure you continue to have appropriate risk management around your loan concentration levels.

CRE loan balance totals nationwide recently reached $2T, causing regulators to revive their message for banks to effectively manage this risk to avoid problems of the past. There are hundreds of banks with CRE loan concentrations high enough to warrant increased attention from regulators and it has been steadily rising since 2013.

Another category of focus is Ag lending, which the report finds is susceptible to commodity price volatility (has been high lately). Also, Ag asset values and borrower equity positions are showing some signs of softening. Banks with Ag loan concentrations should carefully monitor the loans for signs of rising loss risks.

As for O&G lending, the FDIC notes that loan concentration is less widespread than other types of concentrations, but such lending can create greater risks for banks heavily involved in these loans. Banks headquartered in the three energy states of TX, OK and LA are seeing noncurrent C&I loan rates and net charge-off rates rising faster than those of other states. So, if your community bank is closely tied to this industry, make sure that you keep a close eye on escalating risks to avoid regulatory issues.

The bottom line is that risks from credit concentrations in all of these areas are still manageable. But, the fact that the FDIC is monitoring them closely should serve as a reminder for community bankers to punch up loan concentration analysis as you prepare to take remedial action if needed. This is nothing to sneeze at for sure.

BANK NEWS

Spooky Stocks

Barron's research finds stock market valuations measured by market capitalization as a percent of GDP are now at 207%. That compares to 181% just before the credit crisis and 202% just before the tech bubble burst.

Volker Fine

Deutsche Bank becomes the first major bank to be hit with a fine by regulators for allowing its traders to make risky market bets that did not conform to the Volker Rule. Deutsche will pay $157mm in civil money penalties.

Prepaid Delay

The CFPB has delayed its final rule on prepaid accounts from Oct 1 2017 to Apr 1 2018.

M&A Activity

1) Riverview Bank ($543mm, PA) will acquire CBT Bank ($481mm, PA) for about $50mm in stock (100%) in a merger of equals. This is about 1.27x tangible book. 2) UMB Bank ($20B, MO) will sell its Scout Investments unit to Raymond James (FL) for about $172.5mm in cash (100%). 3) United Community Bank ($10.7B, GA) will acquire Horry County State Bank ($376mm, SC) for about $66mm in stock (100%) or about 1.42x tangible book.