# Drilling for Business in the Energy Sector

lending

**Summary:** Domestic and global trends push up demand for oil and gas, creating new lending opportunities for CFIs that specialize in the sector. We discuss the pros and cons of lending to this industry, and what to consider, if you do decide to take the plunge.

J. Paul Getty, who had amassed the modern equivalent of $7.8B through his oil drilling enterprise by 1966, was once the richest man in the world. He had a formula for how he managed to build such a fortune: *"Rise early, work hard, strike oil."*

Financial institutions are not in the business of drilling for oil. But right now might be a profitable moment for community financial institutions (CFIs) to be in the business of lending to the oil and gas industry.

**How We Got Here**

It's been an unusual winter for much of the country, and keeping warm drove up heating bills and demand for fossil fuels. The easing of pandemic restrictions put more cars on the road, and that increased demand for gas. The war in Ukraine caused disruptions in energy supplies, increasing reliance on domestic oil and gas. Then there's China, whose burgeoning appetite for energy helped push global demand for oil to a projected record level in 2023.

It all adds up to more demand for oil and gas from places like Alaska, Texas, and the Gulf Coast. Oil and gas companies are drilling more and modernizing their practices, which takes money. There is also some consolidation taking place. Those capital needs have been a boon for financial institutions that lend to the oil and gas industry, including a number of CFIs located in drilling hot spots like the Permian Basin of Texas. Financial institutions that cater to oil and gas businesses are betting on a strong year.

The rosy projections for oil and gas lending run contrary to larger financial trends this year, as most financial institutions look toward slowing commercial loan demand as interest rates rise and the economy cools. But that has had little impact on oil and gas production.

**Energy Is a Growth Industry**

The US Energy Information Administration projects that US production will reach a new high of 101.7MM barrels per day in 2023 and grow even more in 2024. While the agency predicts a gradual decline in prices, it says increasing demand will more than make up for it.

While oil and gas producers look to expand, the number of traditional lenders may be dwindling thanks to the push toward environmental, social, and governmental (ESG) investment policies being urged on financial institutions. Several large national and international financial institutions have pledged to move away from fossil fuel investments.

**Grabbing the Ring**

All those trends create opportunities for CFIs like Community National Bank and SouthWest Bank, both in Odessa, Texas. SouthWest launched a new oil and gas division last year and expanded into production lending from its traditional base in service companies. Community National has said its oil and gas loan size is larger than last year and that demand is “up significantly.”

Those two are hardly the only CFIs hoping to cash in on oil and gas trends. FirstCapital Bank of Texas touts its ability to provide financing to the industry ranging from $50K to $50MM and says its oil and gas portfolio has more than doubled since 2020.

**A Word of Caution**

While the current situation in places like the Texas oil patch provides tremendous lending opportunities that may not be available to CFIs in other parts of the country, these opportunities come with a note of caution. As lenders to oil and gas know, the industry can be quite volatile. Energy prices tend to fluctuate in response to various global events. For lenders in the space, an important consideration is maintaining a diverse loan portfolio. Too much concentration in one sector can be problematic, which is something regulators also watch.

If you do decide to lend to a business in the oil and gas industry, there is great potential, but also a significant amount of risk. It’s important to assess your portfolio to determine the right mix of industries to reach your goals and how much risk you can tolerate. If you’re looking for customers who can impact your institution quickly, and you haven’t investigated this sector before, it might be time to start your research.

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## ECONOMY & RATES

Rates As Of: 04/06/2023 06:39AM (GMT-0700)

| Treasury | Yields | MTD Chg | YTD Chg |
|---|---|---|---|
| 3M | 4.86 | 0.01 | 0.44 |
| 6M | 4.82 | -0.12 | 0.06 |
| 1Y | 4.40 | -0.20 | -0.30 |
| 2Y | 3.77 | -0.26 | -0.66 |
| 5Y | 3.35 | -0.23 | -0.65 |
| 10Y | 3.29 | -0.18 | -0.59 |
| 30Y | 3.55 | -0.11 | -0.42 |

| FF Market | FF Disc | IORB |
|---|---|---|
| 4.83 | 5.00 | 4.90 |
| **SOFR** | **Prime** | **OBFR** |
| 4.81 | 8.00 | 4.82 |