By Banding Together, CFIs Can Participate in Bigger Loans

lending

Summary: Now is a good time for CFIs to compete for big loans. Doing so may require joining loan participations or syndications. We review the state of the corporate loan market and the differences between the two models.

There are countless proverbs and sayings about the power of teamwork and collaboration. One of the more famous ones is “two heads are better than one.” Another is “when spiders unite, they can tie down a lion.” The gist is the same: teamwork can get you to places that solo effort can’t.

The wisdom of joining together has particular relevance for smaller community financial institutions (CFIs) trying to expand their loan portfolios. Sometimes bigger loans are out of reach for smaller CFIs. To get around that obstacle, CFIs can join with other financial institutions to cosponsor bigger loans. Loan participations are one way for smaller CFIs to break into the bigger corporate loan market, and they have been gaining traction.

The corporate loan market has been a dynamic place for the last few years, falling in 2020 during the business slump that accompanied the pandemic, then soaring in 2021 to make up for delayed lending needs. In a typical year, borrowers have taken out an average $1.1T in revolving credit facilities, term loans, and other vehicles.

Commercial real estate activity is also on the decline. In May, the Mortgage Bankers Association forecasted a 20% drop in commercial and multi-family lending, a result of rising interest rates and falling property values.

That still leaves a lot of large businesses looking for financing, and for them, an important issue may be the shrinking availability of lenders. Many larger financial institutions aren’t looking to expand their commercial lending portfolios, which presents an opportunity for CFIs. The caveat is that it’s not an easy one to exploit.

Constraints on CFI Lending

The amounts big commercial borrowers seek are often well beyond the ability of CFIs to extend. These CFIs may have limits on their lending capability, often because of regulations or their own policies. Smaller CFIs must be careful about concentrating too much of their portfolios in a few very large loans.

The answer is for CFIs to join with other like-minded smaller financial institutions in a participation or syndication, with each institution carrying a portion of the debt that fits within its own constraints. In that way, CFIs that have typically been unable to participate in the large corporate loan market may now have a way in. The companies seeking financing may also be more inclined to work with CFIs at a time when finding willing lenders among larger banks has become difficult.

In one recent case, a borrower seeking to refinance a $10MM loan on an office building specifically stated it did not want to deal with multiple lenders. But when it was unable to land a deal, it ultimately secured a loan by working with two smaller CFIs.

Participation or Syndication

For CFIs that want to increase their return on assets and diversify their portfolios with larger business clients, one of the first questions is which model to use: a participation or syndication. While they are similar, they do have some unique characteristics.

- **Participation.** Several financial institutions can partner in a participation agreement, but all the work goes through the lead lender, who works directly with the borrower. The participants buy shares of the loan from the lead lender, so borrowers may not know who the other participants are. If the loan defaults, only the lead lender can deal with the borrower. There are a number of ways to join a loan participation. PCBB offers a loan participation product for buying and selling loan participations.
- **Syndication.** Two or more financial institutions can join together in a loan syndication and make a loan to a borrower. The syndication agreement sets out the relationship rules for the lenders, and an administrator services the loan. The borrower would work with each syndicate lender for the portion of funding that the lender supplied, and any decisions regarding the loan are made through the administrator.

Which form a financial institution chooses depends on its own situation, needs, and policies. It may also be subject to opportunities and what terms borrowers will accept. Not all borrowers are keen on taking out a loan that has multiple financial institutions as sponsors, but according to CCIM Institute, a community real estate education organization, “with properly drafted agreements there is very little practical difference in the customers’ borrowing experience under either format.”

New opportunities in the large commercial loan market can be attractive to CFIs due to the possibility of expanding their geographic reach, gaining new clientele, and reducing concentration risk. To get over the hurdle of loan size, CFIs may need to consider loan syndications or participations to secure these larger business customers and potentially gain their loyalty and future business.

EXPAND YOUR LENDING

Looking for more lending income? PCBB is actively looking for loan participations, which allow you to increase your lending capabilities and diversify your portfolio. Contact us today.

ECONOMY & RATES

Rates As Of: 10/16/2023 06:30AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.62	0.07	1.20
6M	5.57	0.04	0.81
1Y	5.39	-0.04	0.69
2Y	5.07	0.03	0.64
5Y	4.70	0.09	0.70
10Y	4.71	0.13	0.83
30Y	4.86	0.16	0.90

FF Market	FF Disc	IORB
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**
5.31	8.50	5.32