

Managing Your Commercial Loan Portfolio Through Challenging Times: A Live Webinar Presented by Austin Associates, LLC

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Abbreviated Version



May 25, 2011

Austin Associates' Lines of Business

- Investment Banking
- Strategic Consulting
- **Financial Management** ← Today's Webinar Presenters
- Technology Solutions
- Risk Management and Compliance

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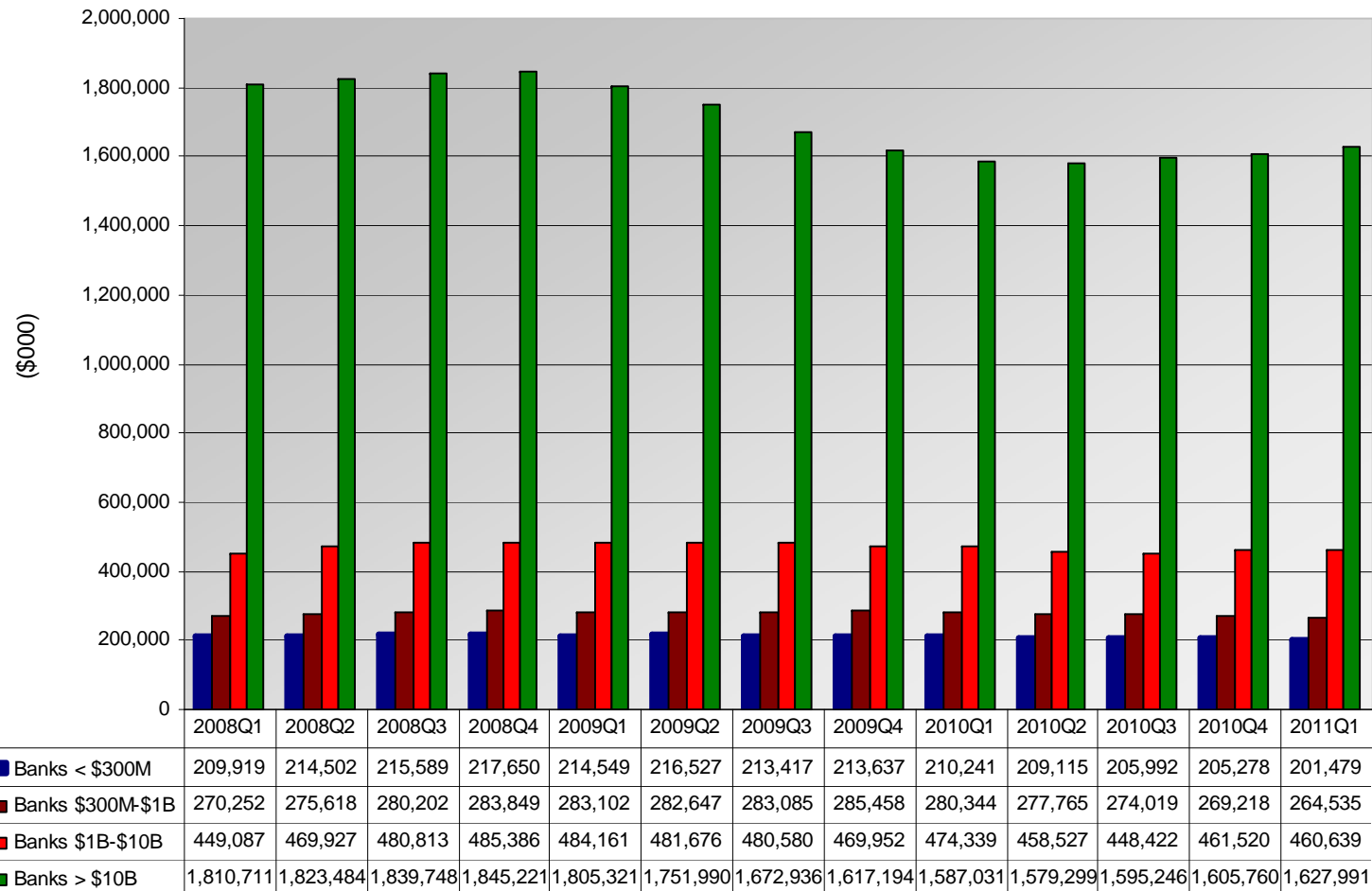
Market Update

- Industry Financial Performance
- Growth / Decline in Commercial Loan Balances
- Trend in Loan Yields
- **Loan Renewals & Commitments ← Key for Today**
- Provision for Loan Losses
- Net Charge Offs
- Past Dues & Non Accruals
- Reserve Levels

Market Update

Decline in Commercial Loan Balances

Balances declining most rapidly at large institutions, causing them to seek growth by courting largest customers of smaller community banks, using low rate / long term offers.

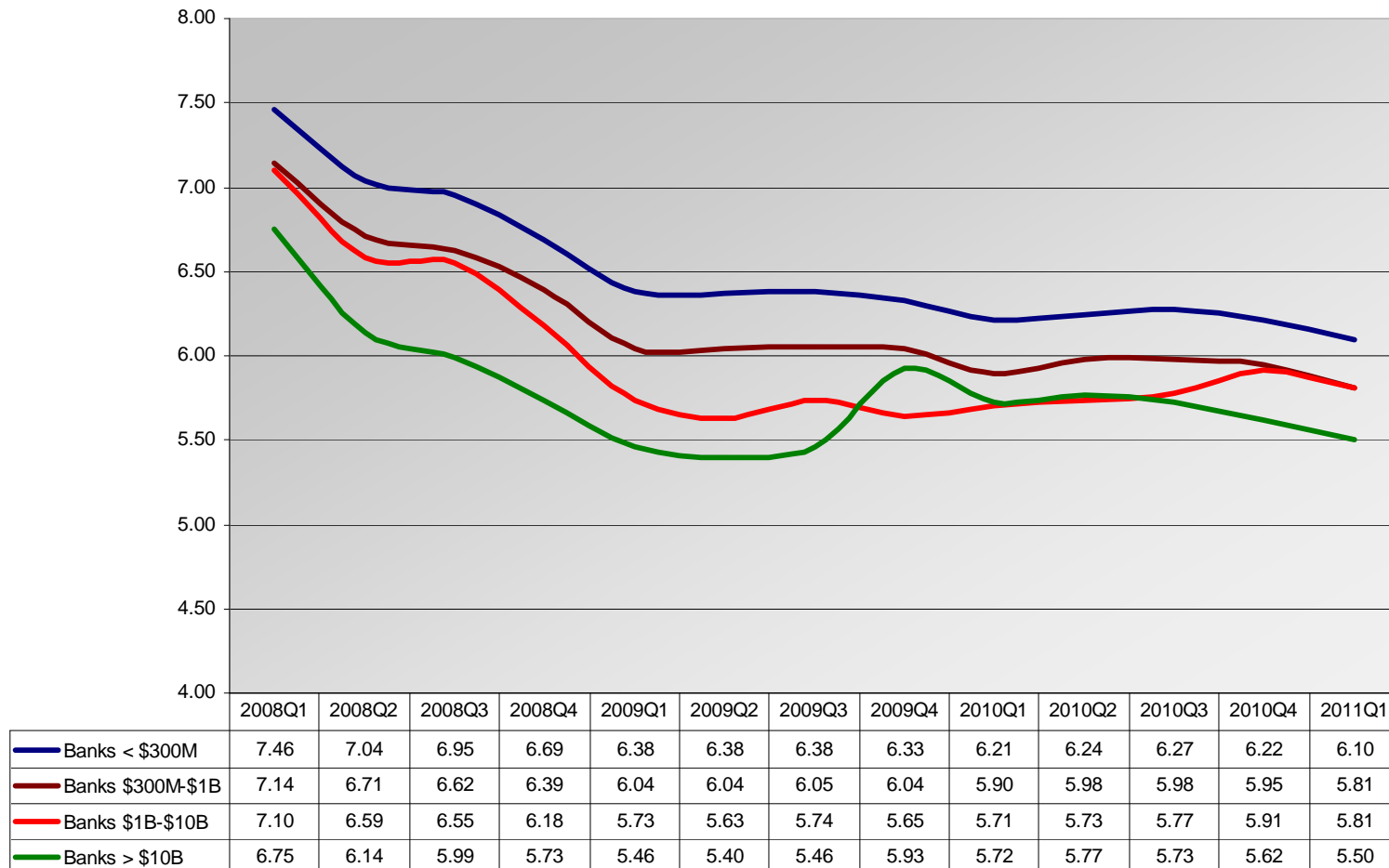


Source: SNL Financial

Note: Aggregate for all US banks

Market Update

Large banks leading the race to the bottom on yields

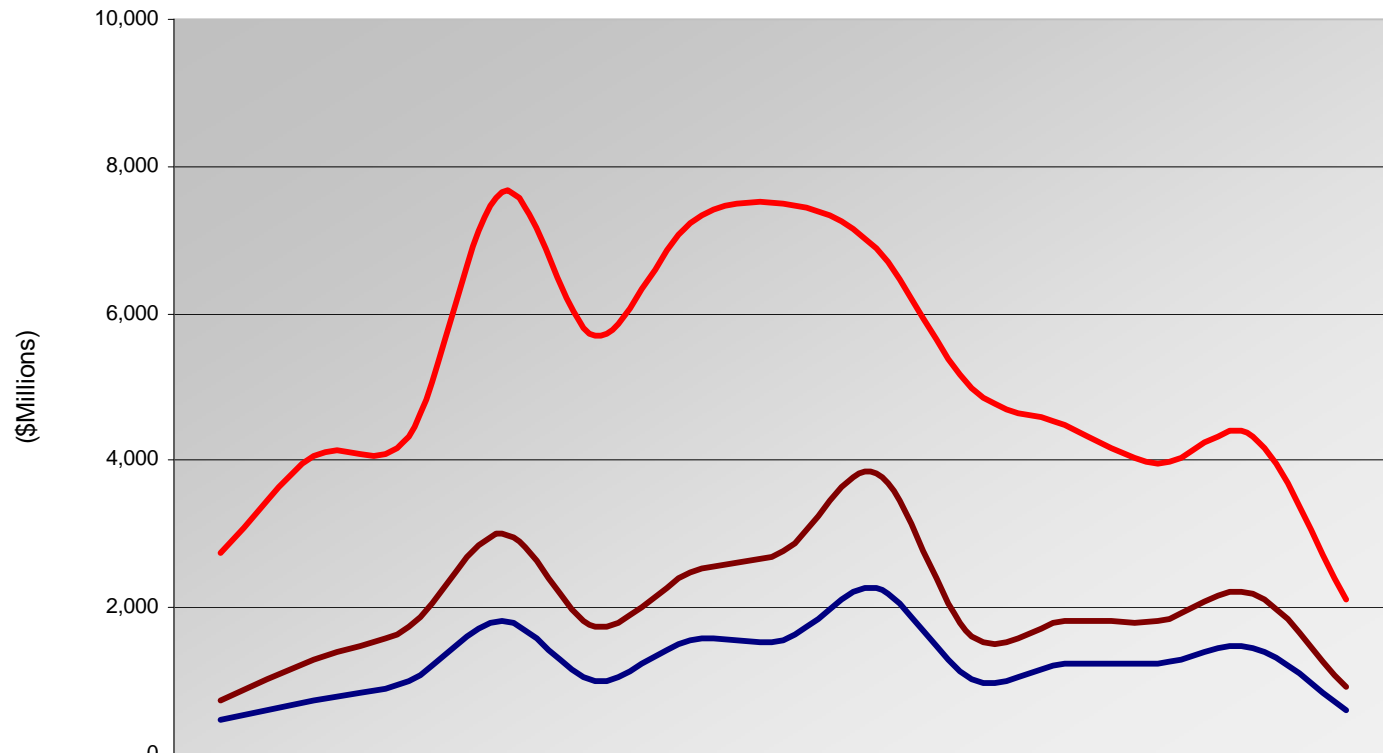


Source: SNL Financial

Note: Aggregate for all US banks

Market Update

Total Provision for Loan Losses



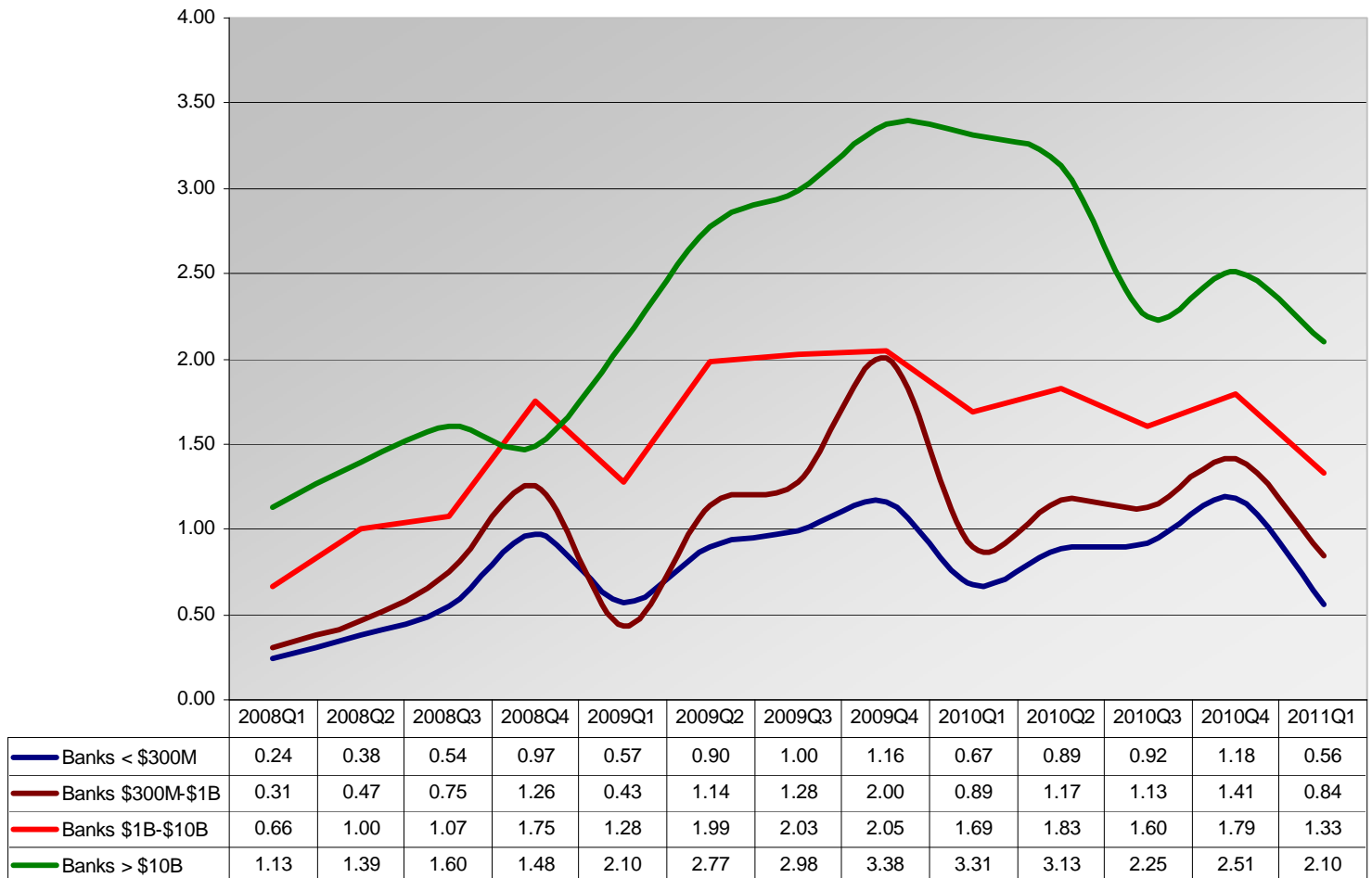
	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
— Banks < \$300M	487	736	1,000	1,829	1,001	1,547	1,560	2,278	1,025	1,253	1,233	1,444	602
— Banks \$300M-\$1B	734	1,281	1,740	3,009	1,730	2,478	2,762	3,833	1,612	1,826	1,820	2,200	931
— Banks \$1B-\$10B	2,741	4,058	4,326	7,653	5,694	7,240	7,499	6,879	4,977	4,492	3,969	4,316	2,104
— Banks > \$10B	33,262	44,451	44,154	59,163	53,016	57,246	52,463	52,511	43,947	33,114	28,099	24,384	15,376

Source: SNL Financial

Note: Aggregate for all US banks

Market Update

Net Charge Offs / Total Loans

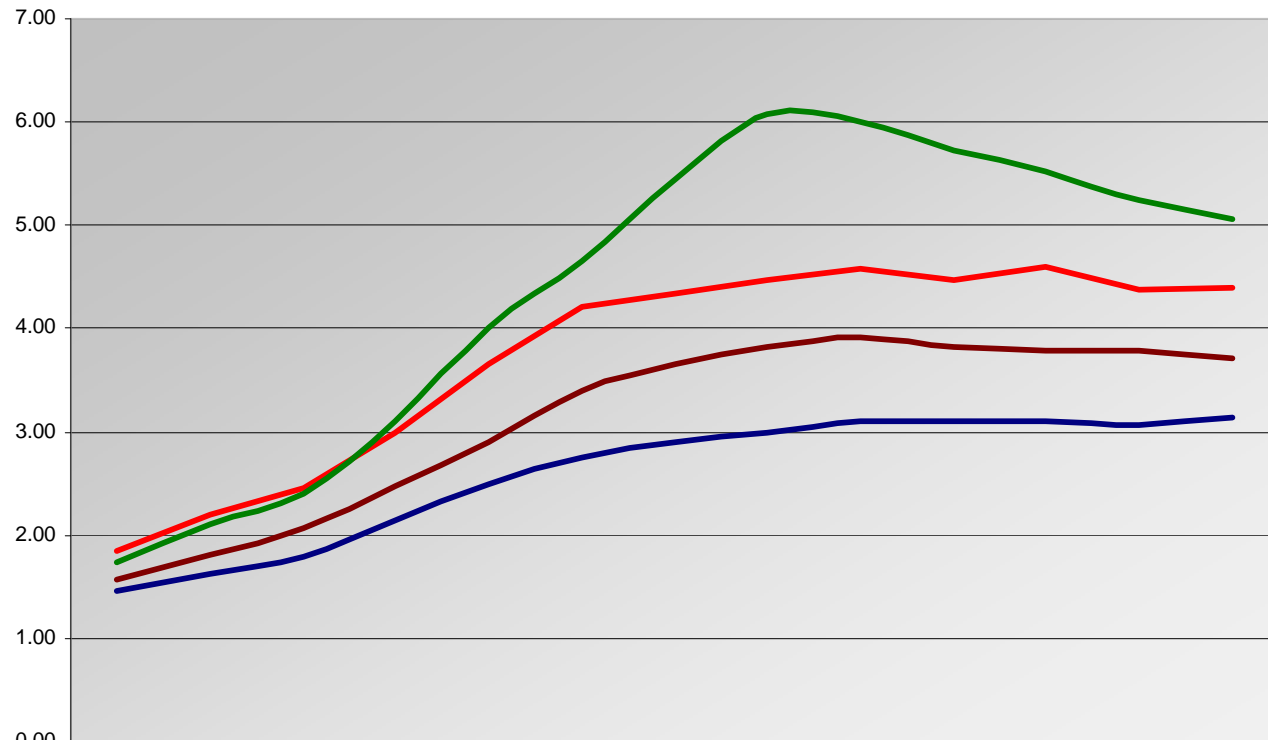


Source: SNL Financial

Note: Aggregate for all US banks

Market Update

(90 Day Past Due + Non-Accrual) / Total Loans



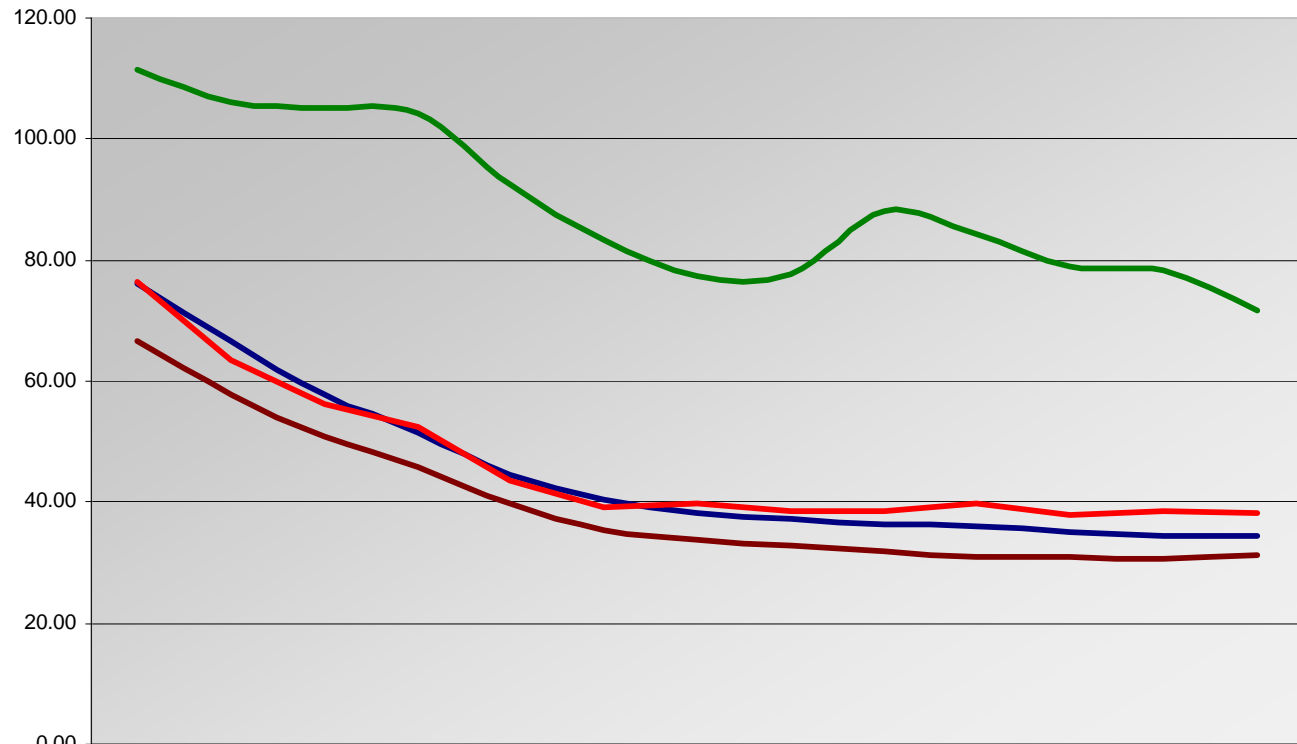
	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
— Banks < \$300M	1.46	1.62	1.80	2.14	2.49	2.76	2.90	2.99	3.10	3.10	3.10	3.06	3.13
— Banks \$300M-\$1B	1.57	1.80	2.06	2.47	2.91	3.40	3.65	3.83	3.92	3.83	3.78	3.79	3.71
— Banks \$1B-\$10B	1.84	2.20	2.46	2.99	3.65	4.21	4.34	4.48	4.58	4.47	4.60	4.38	4.40
— Banks > \$10B	1.73	2.10	2.39	3.09	4.01	4.65	5.46	6.08	6.01	5.72	5.53	5.24	5.06

Source: SNL Financial

Note: Aggregate for all US banks

Market Update

Reserves / Non-Performing Assets



	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
Banks < \$300M	76.06	66.64	57.75	51.34	44.48	40.29	38.10	37.22	36.44	35.85	35.01	34.36	34.57
Banks \$300M-\$1B	66.60	57.84	50.94	45.83	39.72	35.40	33.64	32.82	31.87	30.99	30.81	30.66	31.28
Banks \$1B-\$10B	76.27	63.33	56.30	52.28	43.68	39.20	39.87	38.56	38.53	39.84	37.88	38.57	38.36
Banks > \$10B	111.39	106.20	105.24	104.32	92.54	83.23	77.26	77.57	87.96	84.43	79.05	78.35	71.69

Source: SNL Financial

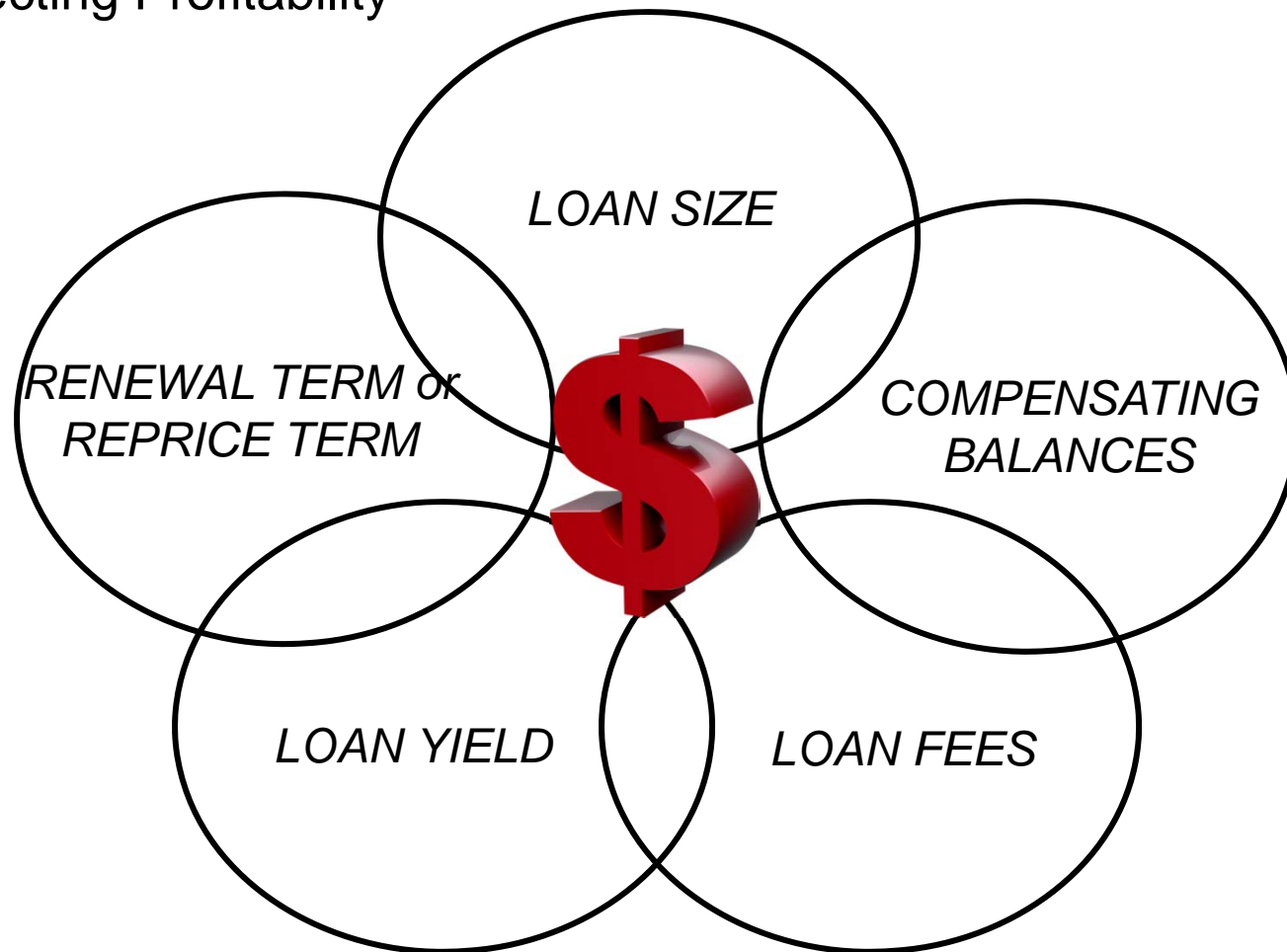
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Managing Your Commercial Portfolio

- **Characteristics of Profitable Lending Relationships**
- **Tools and Strategies for Managing Your Highly Profitable Relationships**
- **Defending Against Predatory Pricing Practices**

Characteristics of Profitable Relationships

In Addition to Credit Quality – Five Other Key Considerations Affecting Profitability



Characteristics of Profitable Relationships

Key Considerations Affecting Profitability

- *LOAN SIZE* – Larger loans generally have higher returns because they can overcome their fixed cost burdens
- *RENEWAL/REPRICE TERM* – Shorter term loans generally have higher returns because of their lower cost of funding
- *COMPENSATING BALANCES* - *Attracting profitable compensating balances will generate higher returns and allow for more competitive pricing*
- *LOAN YIELD/FEES* – This is a “No-Brainer”. Higher yields and fees generate better returns

Managing Your Commercial Portfolio

- Characteristics of Profitable Lending Relationships
- **Tools and Strategies for Managing Your Highly Profitable Relationships**
- Predatory Pricing Practices

Managing Your Portfolio

Officer Profitability - Loans & Deposits

Example Bank & Trust

<u>Officer Name</u>	<u>Portfolio Balance</u>	<u>Annualized Profit</u>		
OFFICER 1	\$45,000,000	\$580,000	\$2,800,000	20.71%
OFFICER 2	\$35,000,000	\$510,000	\$2,100,000	24.29%
OFFICER 3	\$30,000,000	\$400,000	\$2,200,000	18.18%
OFFICER 4	\$20,000,000	\$340,000	\$1,350,000	25.19%
OFFICER 5	\$400,000,000	\$1,000,000	\$17,800,000	5.62%
ALL OTHERS				
TOTAL LOANS & DEPOSITS	\$570,000,000	\$3,510,000	\$29,750,000	11.80%

One of Officer 3's most profitable customers has a loan coming up for renewal

Managing Your Portfolio

Officer 3 - Loans & Deposits

Example Bank & Trust

<u>Customer Name</u>	<u>Customer Balance</u>	<u>Annualized Profit</u>		
ACME Industries	\$6,000,000	\$100,000		
ACME Enterprise	\$4,000,000	\$61,200	\$210,000	29.14%
ACME, LLC	\$5,000,000	\$89,250	\$300,000	29.75%
ACME Home Builders	\$4,000,000	\$63,750	\$240,000	26.56%
ACME Restaurants, Inc.	\$1,500,000	\$25,500	\$90,000	28.33%
ALL OTHERS	\$15,000,000	\$158,100	\$900,000	17.57%
TOTAL LOANS & DEPOSITS	\$35,000,000	\$510,000	\$2,100,000	24.29%

ACME, LLC's operating LOC is up for renewal. They are receiving competitive rate quotes. How do we respond?

Managing Your Portfolio

ACME, LLC Relationship

Example Bank & Trust

<u>Account</u>	<u>Account Balance</u>	<u>Annualized</u>		
Commercial RE Loan	\$3,000,000	\$44,625	\$176,913	25.22%
Commercial LOC	\$1,100,000	\$20,081	\$82,811	24.25%
Business DDA	\$750,000	\$8,925	\$11,292	79.04%
Personal DDA	\$50,000	\$893	\$753	118.55%
1-4 Fam Mortgage	\$750,000	\$14,726	\$28,231	52.16%
TOTAL LOANS & DEPOSITS	\$5,000,000	\$89,250	\$300,000	29.75%

Currently on our books at Prime +150bps, but competitive quote is at Prime +100bps w/ no floor

Managing Your Portfolio

Analyze Existing Relationship With a Pricing Tool

RESULTS

Incl		Average Balance	Profit	ROE %
<input type="checkbox"/>	Loan 1	\$0.00	\$0.00	0.00%
	Loan 2	\$0.00	\$0.00	0.00%
	Loan 3	\$0.00	\$0.00	0.00%
<input checked="" type="checkbox"/>	Others	\$5,000,000.00	\$89,250.48	29.74%
	Total	\$5,000,000.00	\$89,250.48	29.74%

Customer's current ROE is 29.74% with the LOC at Prime +150bps

Customer 111111 - ACME, LLC Relationship

[Reset](#)



New Loan Inputs



Customer Relationship Accounts

Add Accounts from Customer ID: 111111

[Add](#)

*To permanently link customers, use the household feature located on the customer lookup screen.

Select a Product to Add: COMMERCIAL - TERM



[Add](#)

[Historical Rates](#)

[Amortizing Balance Calculator](#)

Include	Product*	Balance \$	Credit %	COF %	Annual NII	PFL %	Orig Exp	Annual VE	Annual FE
<input checked="" type="checkbox"/>	1-4 Family Mortgage	\$750,000.00	5.00%	1.34%	\$0.00	0.50%	\$500.00	\$125.00	\$750.00
<input checked="" type="checkbox"/>	Commercial LOC	\$1,100,000.00	4.75%	0.82%	\$0.00	1.00%	\$500.00	\$250.00	\$1,000.00
<input checked="" type="checkbox"/>	Commercial RE Loan	\$2,350,000.00	5.25%	1.30%	\$0.00	1.00%	\$500.00	\$125.00	\$1,127.00
<input checked="" type="checkbox"/>	Personal DDA	\$50,000.00	3.35%	0.00%	\$0.00	0.00%	\$50.00	\$75.00	\$200.00
<input checked="" type="checkbox"/>	Business DDA	\$750,000.00	1.86%	0.00%	\$0.00	0.00%	\$100.00	\$100.00	\$250.00

Managing Your Portfolio

Revised ROE After LOC Renewal At Competitive Rate

RESULTS

Incl		Average Balance	Profit	ROE %
<input type="checkbox"/>	Loan 1	\$0.00	\$0.00	0.00%
	Loan 2	\$0.00	\$0.00	0.00%
	Loan 3	\$0.00	\$0.00	0.00%
<input checked="" type="checkbox"/>	Others	\$5,000,000.00	\$85,620.48	28.53%
	Total	\$5,000,000.00	\$85,620.48	28.53%

By matching the competitive rate, the ROE of the Customer drops, but still remains highly profitable.

Customer 111111 - ACME, LLC Relationship

[Reset](#)



New Loan Inputs



Customer Relationship Accounts

Add Accounts from Customer ID:

*To permanently link customers, use the household feature located on the customer lookup screen.

Select a Product to Add: [Historical Rates](#) [Amortizing Balance Calculator](#)

Include	Product*	Balance \$	Credit %	COF %	Annual NII	PFLL %	Orig Exp	Annual VE	Annual FE
<input checked="" type="checkbox"/>	1-4 Family Mortgage	\$750,000.00	5.00%	1.34%	\$0.00	0.50%	\$500.00	\$125.00	\$750.00
<input checked="" type="checkbox"/>	Commercial LOC	\$1,100,000.00	4.25%	0.82%	\$0.00	1.00%	\$500.00	\$250.00	\$1,000.00
<input checked="" type="checkbox"/>	Commercial RE Loan	\$2,350,000.00	5.25%	1.30%	\$0.00	1.00%	\$500.00	\$125.00	\$1,127.00
<input checked="" type="checkbox"/>	Personal DDA	\$50,000.00	3.35%	0.00%	\$0.00	0.00%	\$50.00	\$75.00	\$200.00
<input checked="" type="checkbox"/>	Business DDA	\$750,000.00	1.86%	0.00%	\$0.00	0.00%	\$100.00	\$100.00	\$250.00

Managing Your Portfolio

Decision Time - Officer 3

Example Bank & Trust

<u>Step</u>	<u>Portfolio Balance</u>	<u>Annualized Profit</u>	<u>Allocated Capital</u>	<u>Officer ROE</u>
EXISTING CUSTOMER	\$5,000,000	\$89,250	\$300,000	29.75%
CUST AFTER RENEWAL	\$5,000,000	\$85,620	\$300,000	28.54%
EXISTING OFFICER PORT	\$35,000,000	\$510,000	\$2,100,000	24.29%
AFTER RENEWAL	\$35,000,000	\$506,370	\$2,100,000	24.11%
IF CUSTOMER LEAVES	\$30,000,000	\$420,750	\$1,800,000	23.38%

IN THIS CASE, EVEN THOUGH YOU AGREE TO A RATE CONCESSION, IT IS BETTER TO KEEP THE CUSTOMER

Managing Your Commercial Portfolio

- **Characteristics of Profitable Lending Relationships**
- **Tools and Strategies for Managing Your Highly Profitable Relationships**
- **Predatory Pricing Practices**

Managing Your Commercial Portfolio

The large, regional bank in your market is offering your customer “outrageous” terms for their Commercial RE Loan:

- **Prime +50bps, fixed for 10 years, no floor**

Does it make sense to compete? How can they offer pricing and a structure like this?

Managing Your Portfolio

Analyze Loan With a Pricing Tool

RESULTS

Incl		Average Balance	Profit	ROE %
<input checked="" type="checkbox"/>	Loan 1	\$1,621,287.53	\$36,641.99	1.97%
	Loan 2	\$0.00	\$0.00	0.00%
	Loan 3	\$0.00	\$0.00	0.00%
<input type="checkbox"/>	Others	\$0.00	\$0.00	0.00%
	Total	\$1,621,287.53	\$36,641.99	1.97%

Loan is marginally profitable at Prime +50bps fixed for 10 years

Loan Parameters

Loan Structure: Fixed Rate

Loan Amount (\$): \$2,000,000.00

Fixed Rate (%): 3.750

Fixed Term: 120

Adj Rate (%)

Reprice Frequency

Convert After:

Amort Per/Term: 240 Balloon 120 months

Managing Your Commercial Portfolio

Red-flags Associated With This Deal

- Interest Rate Risk
- Credit Risk
- Substandard Return on Equity
- No Compensating Balances to Offset Low Return of Loan

Managing Your Commercial Portfolio

How Is the Regional Bank Justifying This Loan

- Utilization of a Loan Hedging Program that Includes Rate Swaps
- Their Pricing Software Depicts the Loan as Having a Higher ROE due to Lower Capital and Expense Allocation Requirements
- Grow Loans at any Cost Mentality

Managing Your Commercial Portfolio

Does it Make Sense to Compete for This Loan? Probably Not, due to:

- Too Much Interest Rate Risk
- Loan Hedging Programs are Cumbersome to Implement with increased FAS Accounting, Documentation, and Credit Risk Modeling
- Exposure to Credit Risk Over a Longer Period of Time

Structured Pricing Policies

NEED TO UPDATE Why consider adopting a pricing model

- Instills a structured relationship based pricing approach within your organization
- Shows examiners that the bank is serious about using the proper tools to manage their loan and deposit pricing
- Increases profitability of the bank by pricing towards well established targets
- Quantifies pricing decisions. Takes the guesswork out of pricing

Summary of Key Points:

- NEED TO UPDATE
- Base loan pricing decisions on full customer relationship profitability
- Price for risk
- Set ROE targets for Improvement over current actual portfolio average performance
- Reassess risk and loan pricing at each re-pricing opportunity
- Monitor ROE performance by lender – track improvement over time

Managing Your Commercial Loan Portfolio Through Challenging Times

Q & A

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