

Credit won't ease soon, locals say

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Stifel Nicolaus analysts who keep tabs on Midwest banks say 2008 was probably the most challenging year ever for bank stocks, at least in their collective memory. As they see it, the near-term outlook for bank bottom lines is not particularly encouraging either. "We are in the midst of a major negative credit quality cycle that seems unlikely to end anytime soon, which means that nonperforming loans, charge-offs and loan loss provisions are all heading higher, putting ongoing pressure on near-term earnings," analysts Stephen Geyen and Ben Crabtree wrote in their Midwest Bank Monthly 2009 Preview.

So what does that mean for the credit markets this year? Geyen told the Business Journal that the credit environment for businesses will continue to be challenging for some time — and more so for some than for others. All new loans will be severely scrutinized, but real estate and retail will find getting credit more daunting, he said.

Even though the capital position of many banks will improve under the U.S. Department of Treasury's Capital Purchase Program, banks are likely to be less willing to lend while the nation is in the midst of a recession, Geyen pointed out. According to Treasury, the program was designed to attract participation of healthy financial institutions, stabilize the financial system and increase lending for the benefit of Americans and the U.S. economy.

"Their mandate is to protect their providers of capital," Geyen said. "That's not to say credit won't be available; it will just be more restrictive and in some cases more expensive. The reality is that the credit was too easy, but it certainly looks as though the pendulum has swung too far in the other direction.

I don't think we'll see credit 'ease up' until there is some confidence that the economy is beginning to improve, and judging by the economic data, we're not there yet."

Garth Deur, president and CEO of Bank of Holland, agrees that people's lack of confidence in the economy is standing in their way.

He thinks a few things have to happen before people can regain confidence. After Inauguration Day, the Obama administration has to flesh out the meaning of a lot of the legislation that has been enacted in the last few months: Banks are waiting to hear a clear explanation of what is expected from them from the new administration and Congress. Too, Deur said, the country has to work through the crisis in the automotive industry, and people have to start spending again at some level — but spend discriminately this time around.

"From an economic perspective, I'm afraid 2009 is going to be 'find the bottom and build from there,' but we might find the bottom later in the year rather than earlier in the year," Deur said.

Deur believes Treasury's Capital Purchase Program will provide some necessary capital cushion for banks, but he thinks it's a little shortsighted on the part of Congress to think banks are going to turn right around and lend money out as soon as they get it. He said banks are in a bit of a dilemma right now between the Fed, which wants to provide additional capital to promote lending, and the regulators, who are warning the banks not to make another bad loan.

Due to the Fed's actions over the past 16 months, the target interest rate dropped from 5.25 to 0.25, so the prime rate is much lower than a year ago and, in that sense, credit is less expensive than a year ago. For most businesses, however, the issue is not the cost of credit but the availability, Deur pointed out.

"For borrowers who have solid balance sheets, who have histories of running their companies conservatively and surviving through difficult times there will be credit



availability," Deur noted. "Highly leveraged situations will be a bit more challenged."

John Chism, a partner at Plante & Moran who specializes in banks and financial services, works with a lot of banks as well as commercial companies, so he hears it from both sides.

"The banks are very concerned about the business environment and they want to see some positive signs. Like all of us, they're just sitting there wondering what's going to happen on the southeast side of the state," Chism said. "If one of the automakers fall, its demise will have ripple effects all over Michigan. I think because of that banks are generally being conservative."

What Plante & Moran is seeing on this side of the state is that the community banks are making loans to people with good credit and to people with good, viable local businesses. He said there is a dividing line between the large regional banks and the small community banks in terms of the lending they're doing right now. At the banks headquartered, controlled and managed outside of Michigan, management decided not to lend to certain kinds of businesses, Chism said.

"The community banks — the banks owned, managed and operated in the local environment — are actually getting a lot

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of opportunity to make loans to local companies, many of which are larger companies than they ever serviced in the past," Chism said. "They are actively making those loans. So what we're seeing right now is that market share is moving to the community banks."

Chism said a locally owned bank that's investing in the community and is dependent on the community tends to be more supportive of the community. The reality is that banks are in the business of making loans, so if they don't make loans, it's hard for them to make money. The community banks are real interested in looking for good credit, he added.

"I do believe that the guys at the bigger banks would deny this, but I think they have some pretty tight reins on them right now in terms of making loans in the local community," he added. "Some very good, high-quality West Michigan companies are now shopping for new banks: That's the story I'm getting from them."

Deur said there are three basic strategies that small- to mid-sized businesses can adopt to help them work through the credit crunch. First, put together a Plan A and a Plan B for 2009 — an "expected" plan and a "worse case" plan — and be prepared to act on either. Second, it's a critical time for business owners to have meaningful, regular dialogue with their bankers so there won't be any surprises, Deur said. Third, it's a great time to engage employees in the challenges that face them and get them involved in cost-saving efforts, efficiency measures, quality improvements and in suggesting new potential lines of business.

"Nothing draws people together like a crisis," Deur said. "People in West Michigan have a can-do attitude, and if we can get our employees informed and engaged, they will help us through this."

As painful as it is in the short term, I think the things we're going through right now will strengthen us in the long term. I think that with our history of business ownership, employee involvement and the entrepreneurial spirit of West Michigan, we will come through this much better than other parts of the country."