Bond Case Briefs

Municipal Finance Law Since 1971

Small Banks Finally Get Real Shot at Municipal Finance.

Community banks are getting an unexpected shot to compete against Wall Street firms in the area of municipal finance.

Local governments have historically relied on selling bonds to finance operations. The process is cumbersome, but is typically cheaper than borrowing from a bank, even after accounting for legal and underwriting costs.

Low interest rates, combined with rising costs of taking bond issues public, are making traditional loans a more tempting option for many local governments. As a result, smaller banks, many of which already hold municipal deposits, are seizing on an opportunity to bulk up the other side of the balance sheet.

Loans have become "competitive with interest rates obtainable in the capital markets," said Daniel Malpezzi, a lawyer at McNees, Wallace and Nurick in Harrisburg, Pa., adding that an increasingly large segment of local government borrowing has moved away from the bond market.

Banks are eager to take the new business, given the sterling performance of most municipal loans. Banks that have made a business providing deposit and treasury management services to municipalities have proven to be especially well-placed to reap a windfall, though plenty of others seem to be lining up to get in on the game.

Robin Russell, a lawyer at Andrews Kurth in Houston, is set to give a webinar this week on lending to municipalities. Through last Thursday, 36 banks had signed up for the session, which is sponsored by the Texas Bankers Association. While that number might not seem overly impressive, it is up from 11 participants in last year's webinar, Russell said.

"That tells me there's interest," Russell said.

Despite bankers' complaints, the long stretch of artificially low interest rates has been crucial to the growth of bank lending to local governments, municipal finance experts said.

Municipal lending has been growing steadily in Texas the past five years, Russell said, linking the surge directly to low rates. "With tax-affected interest rates on commercial debt at all-time lows, the rate on low-risk tax-free municipal obligations is competitive and attractive to investors and lenders," she said.

Comprehensive statistics on banks' municipal lending are difficult to obtain. Local governments, which are required to make bond issues public, are not required to disclose bank loans.

Individual banks do not always break out their lending to local governments, though the Federal Deposit Insurance Corp. keeps an industry-wide account of loans to "states and political subdivisions in the U.S." Its numbers indicate a steady increase in municipal lending, rising from $66.5 billion in 2010 to $131.4 billion last year.

A quick check of local governments in northern Virginia showed that at least two jurisdictions used bank loans in recent years. In its Comprehensive Annual Financial Report for fiscal 2014, Fairfax County reported borrowing $25 million from TD Bank in December 2013 to refurbish county-owned buildings. Similarly, in its fiscal 2014 report, the neighboring city of Alexandria reported an $18.7 bank loan.

Such loans present an opportunity for banks to deepen ties to local governments, though banks that were already major players have chalked up the greatest gains.

At Carter Bank and Trust in Martinsville, Va., municipal lending jumped 25% in 2014 from a year earlier, to $332 million. Century Bancorp in Somerville, Mass., had nearly $41 million in municipal loans at Dec. 31; it didn't report any municipal loans as late at 2011.

Huntington Bancshares in Columbus, Ohio, has a specialty lending unit, Huntington Public Capital, to focus exclusively on government lending. The yields might not be as high as loans to private-sector businesses, but there are few, if any, problems with the loans, Dave Schamer, the $66 billion-asset company's managing director of government banking, said.

Because of their strong performance, "we don't have to set aside as much capital" for government loans, Schamer said. "Our book is very clean. I can't remember the last problem. … We love the space."

Huntington, which has been lending money to local governments in its Midwestern footprint for decades, "double downed" in the space at a time other banks were abandoning it, Schamer said. "We see it as an opportunity to show our commitment to the communities we serve," he said, adding that public finance "is knitted into the fabric of who Huntington is."

Barry Sloane, $3.6 billion-asset Century's president and chief executive, said his bank was the largest municipal banker in Massachusetts, holding deposits for 200 of the commonwealth's 351 towns and cities. According to the FDIC, Century's municipal deposits totaled $1.1 billion at the end of 2014, comprising nearly 49% of its $2.3 billion deposit book.

Given such dominance, Century's entry into local government lending was relatively easy, Sloane said. "In a lot of cases, we just walked across the hall" to a different official's office, he said.

"We can't do $40 million [deals], but we can do $5 million," Sloane said. "We'll do the little deals, and we'll consider bigger ones."

Sterling Bancorp in Montebello, N.Y., is following a path markedly similar to Century's, taking its municipal lending from zero in 2011 to $33 million on Dec. 31, according to FDIC data. The $7.4 billion-asset company is looking to accelerate that growth, hiring a team of five veteran government lenders last month.

"We feel strongly that the sizable public finance market presents a significant opportunity for growth," Jim Peoples, Sterling's chief banking officer, said in a release announcing the newly hired bankers.

AMERICAN BANKER

by JOHN REOSTI

APR 13, 2015 3:14pm ET