



March 16, 2016

Weekly Post: Participate Loan Transactions

Dear Clients-

Recently I spent five weeks traveling across the country to hold in-depth discussions with many THC clients. In these lengthy meetings, our discussions went beyond regulatory reporting. Much of the time was productively used in evaluating alternative strategies to meet the challenges, such as the funding costs of deposit accounts, CECL analysis, and managing the yield curve risk where short term rates rise while long term rates remain unchanged.

Perhaps the most important banking challenge of all is how to gain access to new loans to grow the balance sheet and enhance income. In my previous Post "Too Small to Succeed?" I wrote in the conclusion that "In this new era of banking, and as the disintermediation process is put into reverse, community banks, and credit unions can take advantage of the opportunity to leverage information technology, enhance operational efficiency, optimize capital utilization, and provide personalized services to customers."

In fact, I believe community banks and credit unions have an opportunity to thrive in this environment. This Post explains "How."

Challenges

- Traditionally community banks and credit unions often participated and worked together to fulfill customers' needs. Disintermediation by Fannie Mae and Freddie Mac disrupted this process. Can modern technologies restore the "participation practice"?
- While there is a demand for loans among banks and credit unions, where can we find loans available for sale?
- Can I make longer term loans in a potentially rising interest rate environment while managing interest rate risk by understanding the impact of funding and leverage opportunities?

Solution

Some of you have already used the Risk Officer function called "Transactional Network." (Just click on the link on the top right hand corner of Risk Officer). Transactional Network enables you to submit your inquiry to buy or sell loans. Web based technologies have created many opportunities to the traditional participation business.

Submit Your Inquiry

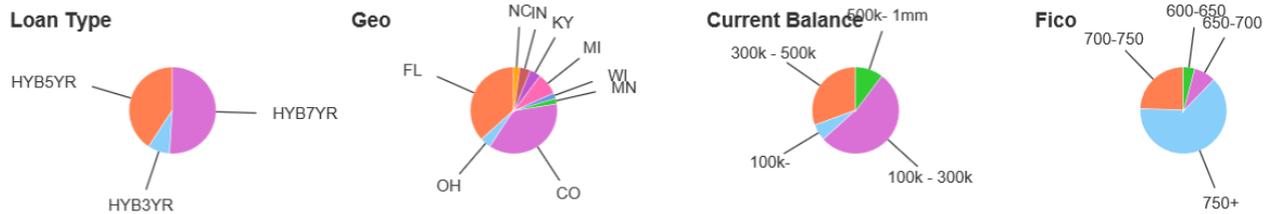
You can search or submit buy or sell inquiries by just entering the transaction type, loan type, credit and geographic info of loans that you seek to buy or sell. Of course, you can also provide your comments/requirements and even more complete loan info such as the loan tape.



Transaction Type	Loan Type	Size	Credit	GEO
Please select the transaction type	Please select the loan types to transact	Please input the \$ size of the transactions	Please input the credit characteristics of the loans	Please input the GEO of the loans
<input checked="" type="checkbox"/> Loan portfolio loan portfolio: loans on balance sheet currently available for sale <input checked="" type="checkbox"/> Loan-by-loan flow loan-by-loan flow: sale of loans from origination pipeline	Loan Type: <input type="text" value="All"/> Loan Category: <input type="text" value="All"/> Seller's Servicing fees: <input type="text"/>	Size(\$): <input type="text" value="10,000,000"/> WAC(%): <input type="text" value="2.50"/> higher than	LTV(%): <input type="text" value="100"/> less than FICO: <input type="text" value="650"/> higher than	<input type="radio"/> All <input type="radio"/> Surrounding States <input checked="" type="radio"/> All States

Search for Counterparties

THC proprietary technology will conduct a comprehensive search to provide a list of best matches between buyers and sellers. Our technology facilitates an indepth analysis which will enable prospective buyers and sellers to evaluate selected loan portfolios. These Asset/Liability Management reports can be used to communicate your proposed decisions in ALCO meetings, Board presentations, and with regulators. An example of a loan portfolio is depicted below. It shows the distribution-of loan types, Geo, Current Balances, FICO and more.



Negotiate

Prospective buyers/sellers can then negotiate the conditions and price. You can attach-files and make comments. All documents are provided to facilitate the process. The communications go through THC support, and the negotiation is anonymous until the letter of intent is executed. Below are examples of messages exchanged between buyers and sellers via THC.

Negotiation

Inst ID	Desc	Last Msg	Last Time	Buyer	Buyer Broker	Status
1625				BankA	THC Ad... Negotiat...	Buy

« « « » 1/1 1 [Refresh](#) Attendees: BankA, THC Advisor

Tom Ho says:

these loans. Please provide further details

Attach File
 Attach Report
 Attach Portfolio
 Attach Strategy Portfolio
 Attach ALM Portal Strategy

Documents : [Letter of Intent](#) [MLPA](#) and [ISA](#)

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Our Loan Transaction process is made efficient: Submit, Search, and Negotiate.

Numerical Example

Web based technology brings efficiency to the Participation process and enables us to transact in small loan amounts. Currently, THC network has access to an estimated 2,000 community banks and credit unions. Memberships are free. All community banks and credit unions are encouraged to join the network because all members benefit from increase participation.

THC ALM state-of-the-art models provide significant value to the Participation. For example, the THC Risk Adjusted Performance (TRAP) Report provides all of the loan’s relevant characteristics for ALCO, Board, and regulatory meetings. An example is provided below showing the analysis of a loan pool: duration, prepayment speed, fair pricing and more.

	Summary		Analytics
Principal Balance(\$)	14,128,798	Short Term CPR(%)	22.04
Participation Balance(\$)	14,128,798	Life Time CPR(%)	20.17
Number of Loans (count)	49	WAL(year)	3.47
Gross WAC(%)	3.203	Effective Duration	2.94
Servicing Fee(bpt)	38	Effective Convexity	-0.84
NET WAC(%)	2.823	Weighted Average FICO	750
WAM(mos)	348	Weighted Average LTV(%)	69
Seasoning(mos)	12	Price	101.26
Serviced Retained By Seller	No	Yield(%)	3.519

Furthermore, the impact of any loan transaction, buys or sell, is analyzed at the balance sheet level. For instance, the demand for loans from another financial institution is so high that you may consider selling your loans to other banks instead of selling to Fannie and Freddie. The benefits of buying the loans with cash can be analyzed using an ALM report presented below. The results show that earnings increase by \$460,000 with an increase 0.77 year in duration.

ALM Analysis	EVE ratio (%)	Duration	% EVE Chg up 400	Short Term /Asset(%)	Margin (%)	NII(\$000)	Earnings(\$000)
Base Case	14.02	8.79	-51.48	16.00	2.54	10,203	1,850
Strategy	14.02	9.56	-54.57	12.30	2.67	10,707	2,310

Conclusions

The THC mission as articulated by the Office of Thrift Supervision (OTS) in 2006 is to dedicate our service to the communities. Leveraging technologies, THC can assist in “leveling the playing field.” And “Too Small to Succeed” does not apply to today’s technologies.

THC Network Transaction enables our clients to transact on prices with transparency in a “market,” similar to Wall Street, irrespective of the balance sheet size.

This Post deals with a complex process made simple in a few paragraphs. Please do not hesitate to contact me if you have any questions about doing your participation or reviewing loan simulations for your institution based on different funding and leverage opportunities.

Regards,



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