nyrej

Bank mergers creating opportunities for non-banks to disrupt CRE term lending model - By Matthew Dzbanek and Matthew Swerdlow

October 11, 2022 - Front Section

Have you watched one of your favorite local/regional banks get gobbled up by a larger financial institution? We have. In the last four decades, the number of commercial banks in the U.S. dropped by 70 percent, from 14,400 banks in 1984 to 4,375 in 2020, which has resulted in a decline in competition among financial institutions nationwide.

As mortgage brokers, we've heard the same story over and over from borrowers whose previously valued "relationship" with a lending partner changes after a merger with a larger bank.
Some clients find that they get lost in the mix as the new institution focuses on different opportunities based on a number of factors including the size and complexity of a deal. For example, we've observed that banks that were previously willing to do a structured loan for an asset with vacancies, deferred maintenance or short-term lease roll are less interested in quoting these same deals after a merger. Typically, the larger, newly formed bank entity opts for easier, larger and more "down the fairway" transactions.

"Non-bank" Lenders Filling the Void

Merger activity has been brisk in the New York market in recent years with additional transactions pending including New York Community Bancorp Inc.'s acquisition of Flagstar Bancorp Inc., which is expected to close in the fourth quarter of this year, and TD Bank's acquisition of First Horizon Corp., which is expected to close in early 2023. Completed consolidations include include M&T Bank Corp. and People's United Financial Inc.; Citizens Financial Group and Investors Bancorp Inc.; Hanover Bancorp and Savoy Bank of New York; Webster Financial Corp. and Sterling Bancorp; Valley National Bancorp and Bank Leumi USA and earlier Oritani Financial Corp.; Victory State Bank and Northfield Bank;BNB Bank and Dime Community Bank; and Flushing Financial Corporation and Empire Bancorp, Inc.

In response to shifts in the banking industry, once more new "non-bank" players are emerging to fill the void and serve the commercial real estate borrowers left behind by bank mergers, specifically in the realm of permanent term financing.

Our team is currently working with a network of alternative lenders with private capital and a mandate to originate 5-, 7-, and 10- year term loans against commercial real estate. These loans can come with either full term interest only or 30-year amortization schedules and have fixed rates, flexible prepayment penalties, non-recourse guarantees and no banking relationship requirement to speak of.

These private lenders aren't household names and don't have brick and mortar footprints, but they are real and are actively fighting to win financing assignments. Even better, since they aren't federally or state regulated, they also have the ability to follow a client's deal flow to almost any state in the country.

How Did We Get Here?

The rapid consolidation of the banking industry began four decades ago and today the country's top four banks—JPMorgan, Bank of America, Wells Fargo and Citibank—hold the same amount of assets as the next 300 combined, about US $9 trillion, according to Jeremy Kress, a former Federal Reserve attorney and now Assistant Professor of Business Law at the University of Michigan.

Kress outlined in an article the three major waves of bank consolidations in the last 40 years that got us to this point:

In the 1980s and 1990s, banks were given permission to cross state lines to merge with other financial institutions, rapidly expanding their footprints and creating larger, regional banks.

In 1999, the Gramm-Leach-Bliley Act allowed banks to engage in previously prohibited financial activities such as investment banking and selling insurance, leading larger banking institutions to engage in mergers and acquisitions to expand into the new business lines.

The 2008 financial crisis was the catalyst for the third wave of mergers, where the biggest lenders acquired smaller financial firms, often with government assistance, creating the "behemoth financial conglomerates that dominate the U.S. financial sector today."

COVID-19 also contributed to bank mergers, Kress wrote. With the Fed setting interest rates at near zero to keep the economy moving during and after the pandemic, lending became less profitable, which left smaller more vulnerable banks ripe for consolidation.

In addition, the Trump Administration repealed several facets of the Obama-era Dodd Frank regulations limiting the size of financial institutions before they're considered "too big to fail" and must go through recurring and expensive regulatory reviews.

Will Merger Mania Continue?

President Joe Biden issued a July 9, 2021 Executive Order on Promoting Competition in the American Economy in an attempt to slow down the merger mania. The President is urging the regulators responsible for approving bank mergers—the Federal Reserve, Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency—to scrutinize them more closely before giving the green light.

“Though subject to federal review, federal agencies have not formally denied a bank merger application in more than 15 years,” according to the Executive Order Fact Sheet. “The result has been excessive consolidation that raises costs for consumers, restricts credit for small businesses and harms low-income communities. Branch closures can reduce the amount of small business lending by about 10% and leads to higher interest rates.”

In spite of push back from the President, Congress and even the FDIC, the bank consolidations have continued, but are slowing due to rising interest rates.

Matthew Dzbanek, Capital Services Professional, and Matthew Swerdlow, Capital Services Professional, at Ariel Property Advisors New York, NY.