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## COMMUNITY BANK LEASING... Emerging Growth Opportunities

By Dale Kluga

JUST AS LEASING HAS ADVANCED LIGHT YEARS BEYOND THE STIGMA OF "LENDER OF LAST RESORT," ESTABLISHED COMMUNITY BANKS AND DE NOVO BANK STARTUPS ARE SOME OF THE MOST PROACTIVE AND GROWTH ORIENTED ENTREPRENEURS IN THE BANKING BUSINESS TODAY.

### Snap out of it!

*Cher exclaims* to a stupefied Nicolas Cage during a humorous movie scene in MOONSTRUCK. Like that passionate, single handed baker, once in a while we could all use a friendly slap in the face to realize new opportunities.

### New Emerging Market

Just as leasing has advanced light years beyond the stigma of "lender of last resort," established community banks and de novo bank startups are some of the most proactive and growth oriented entrepreneurs in the banking business today. Both community bankers and leasing professionals are constantly fo-

cused on similar goals: momentum and growth.

According to Michael C. Braun, President of AmeriMark Financial Corporation, "Community banks or de novo's must be pro-active in creating loan demand. After fulfilling the needs of their "best customer list" they are still selling Fed Funds—maybe at a negative spread. Leasing is one avenue to increase net interest margin and absorb the excess Fed Funds."

One look at the \$83 billion represented by the 50 largest U.S. Bank Affiliated Leasing Companies as listed in the *Monitor Bank 50*, and we can see the emerging presence of big bank

leasing. Most big bank leasing started on a modest scale very similar to de novo community bank startups.

### Community Bank Growth

Growth in the bank community is being fueled by much of the same symptoms in the leasing industry: consolidation and opportunity. Crowe, Chizek and Company LLP, the nation's 9<sup>th</sup> largest CPA firm and a leader in servicing the community banking industry, has determined that over 1,525 new de novo banks have been established in the United States over the last 10 years.

According to Michael Law, a partner in Crowe Chizek's Finan-



cial Institutions Group, banks started in the last ten years in Illinois control approximately \$5.3 billion of the state's banking assets as of December 31, 1998. Law commented, "Since almost all of these banks started with less than \$10 million of capital and assets, the growth has been impressive."

Law explains, "The de novo bankers have generally been successful in attracting retail and small business customers who appreciate personal attention and quick responses on credit requests. The successful ones know their communities well and often benefit from a portable customer base that follows the president and senior lender to the new bank. Location, as always, is key. Successful de novo banks are usually found in communities where there are no other locally owned independent banks."

### **Fear and Ignorance**

As one of the most nimble and efficient financial service providers, the leasing biz is quick to focus on and service fast growth industries. Yet, the old fashioned stigmas still prevent us from pursuing joint venture relationships with community bankers. Fear and ignorance are frequently the obstacles to or causes of failed relationships. Fear that we will cut our own throats by educating bankers and helping them enter an already highly competitive biz. Perhaps. Fear that bankers will lose account control and credit quality. Maybe. Focusing on our similarities rather than our fears, creates a path to creative solutions. Taking a big picture view may also help.

### **Create Differentiated Value**

Reality is that any time you create differentiated value, someone will at least listen or possibly

even buy your product. Reality is also that both bankers and lessors have very common traits. Maybe it is our anal retentive nature or our incessant need to negotiate. Whatever the case may be, whenever you properly train people in a new biz, they are likely to become more independent.

Independence builds relationships which creates new opportunities. In the case of educating bankers, the payback may follow in other ways. The bank may provide you with a line of credit or refer potential investors to you. Vendor program referrals are very common assuming you educate your banker on how to uncover these opportunities. The bottom line is that if you don't take action, your competition will. There I go again with that fear based, anal attitude.

Media awareness has created a higher level of acceptance in funding and using emerging technology to grow our biz. Community bankers too are soaking it up. Community bankers are extremely agile and need to create product differentiation to survive, not just prosper. Technology levels the playing field with their larger big bank competitors. Properly applied technology can boost the effect of differentiated value.

### **Converging Cultures**

Community bank and leasing cultures are on a direct, converging path: both industries are consolidating and creating "niche vacuums" of under-served small business customers. The de novo bank expansion is being fed by this rapid growth in community based, small businesses.

Technology is leveling the playing field for these small businesses just as it has for the leasing and banking industries.

Bigger is no longer better. Our common experiences can leverage our ability to develop relationships with these de novo institutions.

Make no mistake, these de novo's are not reckless cowboy bankers. Frequently, the management teams consist of sophisticated, re-incarnated management teams and investors from a prior banking institution who have just waited out their non-competes and are re-deploying prior networks.

Community bankers and lessors primarily sell on service not price. Community bankers understand the non-bank competitive forces as their customers increasingly seek non-bank sources. A recent survey conducted by the American Banking Association identified convenience and good customer service as the major reasons for seeking non-bank institutions.

### **Emerging Small Business**

American Express and Merrill Lynch are recognized as significant non-banks aggressively seeking to expand their national reach to emerging growth small biz customers. Just as commercial paper displaced Fortune 500 lenders in the early 80's, community bankers are well aware of these non-banks which are establishing a foundation for a new form of national capital market access for small biz.

The writing is on the wall for small biz community banking. Even a study conducted by the Banking Administration Institute and McKinsey & Co., Inc. warns of "emerging non-bank competition" from various institutions and claims that commercial banks have less than half of the small-biz market today.

A leasing product is an ideal cross-selling and asset manage-



ment tool for any growing community bank. A leasing product sold on the basis of a quick, flexible convenience tool is a perfect fit. Particularly since the traditional forms of indirect auto and retail paper are quickly being soaked up by the large national finance companies.

Crowe Chizek's Law believes the community bank leasing market is under-served, "Community banks have not done leasing in a big way. Most lease deals are rated credits with paper thin margins.

Full-tax equivalent yields on financing school buses, fire trucks or college computers can be attractive, although each credit has its own risks."

#### **Non Creative Bureaucrats**

Think again. Community bankers in many ways are the front line funders to early stage companies. What community bankers may call a home equity line of credit or cash secured loan, we call subordinated debt or venture financing. Community bankers come up with creative solutions despite the fact that they have to deal with a highly regulated environment, something our industry may have to deal with someday soon.

Law does see the potential in a working relationship between bankers and lessors, "Banks have teamed up with leasing companies on operating lease deals. The leasing company can bring specialized expertise to the table in structuring and documenting the deal. Relatively few community banks have such expertise, the leasing company can fill this niche."

Community bankers are some of the most unconventional and spirited entrepreneurs anywhere. They just don't like to broadcast it. Establishing inter-

nal leasing divisions, creating interactive internet banking sites, offering an electronic daily loan and deposit auction, buying a fleet of black and Gold VW Beetles to pick up deposits from their customers, offering 7 day service to its customers, underwriting construction loans with lightning speed. The list is long.

Just a few examples of the new breed of entrepreneurial bankers who have begun to compete with the big dogs by providing top notch service and

### **REALITY IS ALSO THAT BOTH BANKERS AND LESSORS HAVE VERY COMMON TRAITS.**

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making decisions based on substance over form. Seem familiar No different than the leasing biz.

#### **Entrepreneurial Bankers**

A contradiction of terms? No more. Martin Dickson, is Senior Vice President and founder of ACB Leasing, the captive leasing division of American Chartered Bank, a \$400 million community bank group located in Schaumburg, IL. A former banker and lessor from M & I Leasing, Marty is encountering strong demand.

According to Marty, "A leasing product offered by a commercial bank expands the perception of sophistication specifically in relationship to the marketplace. Besides being a fee generating or loan origination product, it is also defensive in nature. A leasing presence diffuses the bank's customers from initiating "lending" relationships with

competitive lending institutions, no matter the size of the initial lease request."

Community bank internet entrepreneurs are getting results. First National Bank of Hudson opened its web site in 1996, loaded up e-banking software and in 1998 launched internet banking services. According to the article published in the ABA Journal, it signed up more than 1300 e-banking accounts in the first year which results in accesses of 8,000 per month. The activity is already comparable to its five year old voice system.

The ABA article references another community bank, First Interstate Bank of Alaska, who opened a community business directory website and recently established a Ubid program. The product is a blind, daily loan/deposit auction.

Community bankers are no pushovers. However, if the product structure you propose fits within their culture and it performs as planned, expect them to soak it up quicker than you can supply.

#### **Win With the Bank**

Most lessors are perceived as "transactional" which is not a common strategy of community bankers. The greater your relationship approach, the higher the probability of success. Relationship implies that both parties are reasonable about their respective strengths and limitations. A banker cannot expect a lessor to limit its role to servicing unless it is properly compensated. Similarly, a lessor cannot expect to fund the lease unless it is competitively priced and structured.

Identifying the best leasing product fit for your bank prospect is the second most important key. Law notes the increasing acceptance of outsourcing among community banks, "Bankers are outsourcing more and more func-



tions including IT, auditing and loan review. Partnering with a reputable and reliable leasing company could result in the best of both worlds, with the leasing company providing expertise and the bank satisfying customer needs."

Successful partnerships provide the local bank with both protective and economic incentives. Offer the bank the option of either holding the asset or earning a fee. Choices reduce objections and diplomatically uncover hot buttons.

Listed below is a general checklist to use in preparing a bank leasing program:

- Request a copy of the publicly issued balance sheet and determine the amount and nature of the loan vs. investment portfolio; asset growth over the last year; profitability of the unit.
- Determine if the bank is independently owned and try to network with board members who operate businesses in your community.
- Arrange a brief introductory meeting with the President or Senior Lender and find out: sources of fee income; amount and type of business loans; extent of leasing experience; the number and experience level of their commercial lenders; credit criteria; legal and house lending limits; lending specializations; industry prohibitions; knowledge and ability to underwrite and service leases.

Once you have compiled the above information, you should

have a good idea of the lending culture, transaction size and credit criteria. Next you need to determine if they want to use leasing to build assets, "overline" their lending limit transactions or generate fee income.

Four basic leasing products can be offered to community banks:

- Indirect Lease Purchasing (ILP)
- Direct Lease Origination (DLO)
- Vendor Lease Origination (VLO)
- Bank Equipment Leasing (BEL)

Generally, it is best to use a "one step" ILP approach for bankers having little or no leasing experience. ILP allows the bank to gauge payment experience before committing resources to the function. Active buyers of auto paper are good candidates for this approach.

Assuming the ILP product works, the DLO product can be introduced next. DLO is a proactive business development tool. DLO allows a bank prospect to test drive the bank by "dipping their toe in" without jumping head first into a new bank relationship.

VLO requires intimate knowledge of the selling and lease structuring process and usually requires a banker with some level of leasing knowledge. Servicing is a major issue for a bank when undertaking this product line.

BEL is a product which can be offered to the de novo community bank to help them finance equipment for new branch locations or to liquefy dead, fixed assets into cash through a sale leaseback transaction.

The key factor in offering the above products depends on the amount of credit and operational risk the bank is able and willing to accept. Offering to fund and or service the leases reduces the bank's risk level while simultaneously helping them expand their product offerings.

MOONSTRUCK relationships like Cher and Nicolas Cage are unique and produce valuable box office results. There is no reason why banking and leasing cannot produce the same outcome, even if we need the occasional wake-up call. ■

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*Dale R. Kluga is President of Cobra Capital LLC having co-founded the company in 2000. Cobra provides funding and servicing to the leasing and banking industries. Mr. Kluga previously founded both Great American Leasing Company and the leasing subsidiary of Bank. A graduate of the Continental Bank Wholesale Banking and Financial Information Services Training Programs, he is a certified public accountant and received his B.S. in accounting from Northern Illinois University in DeKalb, IL.*