Equipment Finance Is Key Differentiator for Banks

By Tom Grady

If your bank is not offering – or at least considering offering – equipment finance to your customers, you're missing out on an important product differentiator, so says a respected industry expert who works with banks on the topic.

Scott Wheeler, president of Wheeler Consulting and a certified leasing professional, says most community banks don't understand the power of leasing. Wheeler, who recently authored a white paper on the subject, *Community Banks and Equipment Finance – What It Takes to be a Success*, says he sees increased interest for equipment finance by regional and community banks.

"Equipment finance is a natural extension of what community banking is all about," says Wheeler, who consults with banks nationwide. "For banks looking to diversify and differentiate themselves, it could be a very nice option for them."

Wheeler likens equipment finance (a.k.a. leasing) to other C&I products offered by banks. He calls leasing a cash-flow product that is designed to maximize the customer's working capital by more closely matching capital expenditures with revenues. Equipment finance has not been a popular product offering for most banks, which often do not have the back-office systems or personnel in place to serve as a lessor. Instead, most banks have relied on commercial real estate, residential mortgage and consumer lending to fill up their respective loan portfolios. When he talks to banks about equipment finance, Wheeler says he often hears the same response.

"Banks tell me over and over that their customers never lease equipment and that's why they don't offer it," he says. "And I tell them, think again."

The Small Business Administration estimates that 80% of all small businesses lease all or some of their equipment. Similarly, Capital Resources LLC recently found that up to 85% of businesses lease some type of equipment. The Equipment Leasing and Finance Association (ELFA) reports annual activity of more than $725 billion in equipment finance. Wheeler says it's not hard for banks to determine which customers are leasing equipment.

"An easy way to know for sure whether or not their customers are leasing equipment is to conduct a routine UCC search," he says. "Start with your top ten C&I customers. Most bankers are amazed to see how much equipment their customers lease with outside sources."

Whatever the reason banks shy away from leasing, performance is not one of them. Lease assets have posted a remarkable run that does not appear to be coming to an end any time soon. Data released by the Federal Deposit Insurance Corp. (FDIC) show lease finance remains the top performer within bank portfolios – making leasing among the safest forms of lending. During the last five years alone no asset class has outperformed leasing.

Charge-Offs (%)	2012	2011	2010	2009	2008
Leases	0.16	0.33	0.74	1.44	0.78
Multifamily	0.25	0.72	1.57	1.70	0.86
C&I	0.42	0.78	1.54	2.72	1.62
Residential Mortgage	1.01	1.30	1.79	2.47	1.48
Credit Cards	3.74	4.38	7.41	9.80	6.17
All Loans/Leases	0.97	1.38	2.30	3.00	1.95

Source: FDIC (All periods Q4)

Despite the impressive results, Wheeler cautions lenders new to leasing. He says that performance will return to more historical averages. And he's hoping that when it does, lenders aren't scared off by it.

"Leasing will eventually revert to its historical norms in terms of non-current and charge-off percentages," he says. "But even when that happens, we're talking about a one percent charge-off rate. That's minimal compared to what we saw in commercial and residential real estate, where charge-offs were easily running two to three times that high."

Assets Hard to Come By

While offering leasing might seem like an easy alternative, most banks find today's landscape anything but. Delinquencies and REO aren't the main concerns any longer – competition for customers is. As a result, advance rates are rising and lenders are slashing rates just to keep existing relationships. In May, *The Wall Street Journal* reported that while bank profits hit a record $40.3 billion in the first quarter of 2013, the industry's average net interest margin fell to 3.27%, the lowest level since 2006. Moreover, the banking industry saw a drop in loans outstanding by nearly $37 billion. This news is particularly troubling to community and regional banks. While they cannot match their larger competitors on price, Wheeler says smaller banks can compete in product offerings.

"Their customers are getting equipment financing from somewhere," he says. "And if it's not from them, it's likely from a competitor. Banks have to think competitively. Your product mix has to be so complete that your customers simply have no need to go anywhere else."

Like the best small businesses, the top community banks are entrepreneurial and nimble – not burdened by huge overhead, slow decision makers or timidity. When they see an opportunity, they pounce on it. Wheeler says that even though it has long been considered only a big-bank product, equipment finance is becoming more readily accepted by smaller banks.

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Evaluating your options

Many cloud provider options are available, each with unique risks. As you evaluate your choices and the associated risks, consider the following:

- Cloud providers are sometimes reluctant to produce third-party audit reports unless an audit clause is included in the contract. Some hosts require clients to pay for reports.
- Some internal audit departments are performing control reviews of cloud providers, in addition to receiving and analyzing third- party audit reports. This is driven by certain controls not being tested, exclusion of pertinent systems, or other factors that require on-site testing.
- Standard cloud provider audit reports typically do not include vulnerability/penetration testing results. Providers are hesitant to allow scanning, as they believe this may compromise their infrastructure.

Cloud computing is a widely used format and we don't see this changing anytime soon. Knowing that you are managing the risks associated with housing your sensitive data offsite will give you confidence with the platform, so you can take advantage of the opportunities presented by the cloud. ■

Sue Ulrey
Risk Services Partner
CliftonLarsonAllen
sue.ulrey@cliftonlarsonallen.com
317-574-9100

Randy Romes
Information Security Principal
CliftonLarsonAllen
randy.romes@cliftonlarsonallen.com
612-397-3114

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And why not? Performance has been stellar and equipment financings generally have shorter terms than other traditional lending products. In an environment where interest rates are due to rise, lenders want no part of longer-term, fixed rate financing. And because of the specialty nature of leasing, most lenders are able to command an above-average yield compared to the actual risk they are taking.

Getting into the leasing business requires the commitment of the entire bank. Whether it starts its own leasing division in-house, or partners with an outside finance company to deliver a leasing solution to its customers, bank executives have to engage everyone in the process in order to make it a success. Wheeler says everyone – from the chairman down to the operations team – has to be committed to equipment finance for it to have a meaningful impact. And while he admits that equipment finance is not for everyone, he says it can be an important arrow in a calling officer's quiver.

"If I were calling on a customer or prospect, knowing loan demand is way down, I'd want to have as many product offerings as possible at my disposal," he says. "Otherwise, those customers will look elsewhere for a solution." ■

Tom Grady
Vice President, Capital Markets
K2 Capital Group
952-224-2479
tgrady@k2capitalgroup.com
www.k2capitalgroup.com.

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