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Real Estate Lending: The Value of Community Banks

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Community banks throughout the nation are struggling due to a low-interest-rate environment that compresses margins, weakens loan demand, lowers returns on excess deposits (that are then invested in marketable securities), keeps a low ratio of loans to deposits and increases regulatory costs. While large banks are turning to automatic credit-scoring technology to control costs, most community banks consider it a distinct advantage that they spend more time getting to know clients and their businesses through one-on-one meetings and rarely resort to automated credit-scoring-models to make loan decisions.

Most community banks are not major players in home mortgage lending or in extending small consumer loans. The mega banks and credit unions have some advantages in these niches. Community banks, do, however, continue to play a significant role in extending business lines of credit and in making commercial real estate loans, such as investment real estate, construction lending, owner-user and multi-family.

Large banks have turned to interest-rate wars to win commercial real estate loan opportunities away from rivals and away from smaller community banks. It remains to be seen in the years ahead if banks will suffer the consequences of negative spreads when deposit rates return back to normalized historical levels and these low yielding loan assets remain on their books.

Where the community banks often hold a competitive advantage is in situations where flexibility is called for in the credit structure, and knowing a client's reputation and business history can make the difference.

The mega banks are investing millions of dollars into technology to better refine their automated underwriting approval process in order to reduce expenses. These technology investments take the form of remote loan application submittal, semi-automated application turnaround and one- to three-day loan approval response times with automated documentation production and little or no human intervention to impede the process.

This process will generate significant amounts of low-rate, no-touch, no-time loans for these mega banks, but while it may sound attractive, many borrowers may get turned down for such loans because technology has limitations.

This is where community banks enter the picture as niche bankers with the experience and creativity to fill the void left by these limitations. Borrowers may pay a modestly higher rate with community banks, but with human contact and flexibility, you will gain much more than you get when your sole focus is on just trying to secure the lowest interest rate on a real estate loan.