CREDIT CHRONICLES

A publication of the Hampton Roads Chapter of the Risk Management Association

Fall 2016 Edition

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FROM YOUR CHAPTER VICE PRESIDENT

Happy Autumn!

After those 95 degree days in August, isn't it wonderful to feel the Fall temperatures in Hampton Roads? We are excited to return to a new RMA Chapter year! I am Susan Towler, your 2015 – 2016 Hampton Roads Chapter Vice President. I lead the Portfolio Management Team in the Virginia Division for SunTrust Bank, where I have 28 years of service. In 2014, I became involved with our local RMA Chapter because I wanted to promote education and programming opportunities for credit professionals throughout our beautiful region.

Join us this year when we introduce programs to local credit professionals including our popular Lunch & Learn sessions, the Annual Chapter Meeting, local open enrollment courses in various locations, and networking opportunities through our Young Professionals initiative. We are also expanding our focus on student enrollments this year as we build a bench of future credit professionals by reaching out to local college students with scholarship opportunities.

We take pride in being part of the local landscape of professional organizations and look forward to another outstanding year filled with renewed business contacts, new friends and lots of success!

All my best,

Susan Towler, Vice President

Fall 2016-Spring 2017 Calendar of Events

November 13-15, 2016: RMA National Conference to be held in Dallas, TX
January 19, 2017: Lunch and Learn; Topic: Real Estate Lending – What Me Worry?; Location: Williams Mullen in VA Beach; Presenter: Dev Strischek (*Read more on page 4*)
February 2017: Young Professionals Event; Location: TBD
February 2, 2017: Open Enrollment; Topic: "Business Writing for Bankers" in Suffolk, VA
April 25, 2017: Open Enrollment; Topic: Analyzing the Commercial Borrower's Industry, Market, and Competitive Risk in Suffolk, VA
May 4-5, 2017: Carolinas-Virginias Spring Conference in Williamsburg, VA

Volunteer Spotlight: H. Chandler Wessells, III

First of all, just call him Chandler.

Chandler can easily be described as ambitious. He holds a Bachelor of Science in Business Administration with a concentration in Finance from the University of Richmond – Robins School of Business, and graduated from the Virginia Bankers School of Bank Management held at the University of Virginia. Professionally, Chandler entered the Investment Services Industry in a sales capacity, and worked in Investments for 4 years before transitioning to Commercial Banking. Chandler started his Commercial Banking career with Hampton Roads Bankshares, where he moved up the chain from Credit Analyst I to Vice President of Marine Finance.

Chandler doesn't get much rest outside of work. He travels, brews beer, plays sports, rides boats, plays guitar and writes music. He also has trouble leaving his love of finance at work, so he trades stocks in his free time.

RMA allows Chandler to keep track of relevant market trends and share his experiences with colleagues in the banking community. He sees RMA as a great opportunity for networking and helping people enter and succeed in the banking industry. He looks forward to expanding his role in RMA as one of its Vice Presidents.

Multi-Family Lending Bubble Yet to Burst

Since 2014, the headlines have told us a multi-family bubble is building. There is certainly no lack of data to support the assertion that multifamily construction has been growing in most urban centers. Whether or not the increase in construction has fueled a bubble that is about to burst depends on who you ask. Leasing agents will cite the fact that, to date, vacancy rates are steady to decreasing in most urban markets and rents have continued to climb. However, if you focus on the pipeline for delivery of new buildings in 2016 and 2017, it appears that the test of the sustainability of low vacancy levels and growing rents has only just begun. One source which examines the dynamics of the multi-family markets in 62 MSAs puts 34 of them late in the expansion phase, signaling that increasing vacancy rates and stagnant or decreasing effective rents are on the horizon. Yet, not all multi-family properties are equal. The bulk of new construction consists of luxury urban buildings with high cost to build requiring ever high rents to support the debt. In the meantime, existing multi-family projects in urban neighborhoods and suburbs are becoming more attractive given the lower rents and larger space.

The picture becomes even more confused when you examine the drivers behind increased multi-family absorption nationwide. Most sources cite millennials' desire for urban living with short commutes and lack of the responsibilities of home ownership as a primary force. But the ability of millennials to pay an ever larger portion of their salary in rent is questionable. Employment statistics tell a story of growth on the surface, but reports of decreases in labor participation rates and under-employment belie the statistics.

Without employment growth, the sustainability of multi-family absorption rates is suspect, as is the ability to maintain current rent levels. Finally, there is no consensus on when the pendulum will begin to swing from rent to buy. As renters with strong incomes are able to save for a down payment and mortgage rates remain low–with the threat of increases around the corner–will the pool of renters begin to flock to home ownership just as the bulge in the new multi-family construction pipeline hits the market?

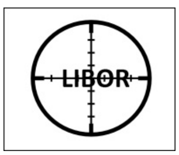
One thing that is clear about the multi-family market is the need for lenders (and developers and investors) to be disciplined and maintain sound underwriting standards. Understanding the underlying economic and demographic drivers in the MSA and the submarket where a property is located and the pipeline of new projects, both rental and for-sale, is even more critical in this stage of the cycle. Lenders must be cautious not to over-leverage projects by underwriting to trended rents and abnormally low vacancies. Underwriting must focus on sustainable NOI and amortizing debt service coverage rather than a low loan to value that can be attributed to a low cap rate. Loan structures need to include leasing and debt service covenants that track to a normalized absorption projection, supported by interest and operating reserves that are in sync with those assumptions.

Multi-family bubble? Yes, some sectors of the market are a cause for concern. Continue to make new multi-family loans? Yes and no; some sectors of the market display strong demand dynamics at a relative value that support multi-family investment, but it is challenging to make new construction work in many markets.

From the Credit Risk Council 2016 Industry Insights

Does LIBOR Have a Death Sentence?

By David C. Hiltebrand, Attorney at Williams Mullen



The London Interbank Offer Rate, affectionately known as "LIBOR," is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another. It has been used in the financial markets since its creation in 1986 (Happy 30th Birthday, LIBOR!), and became one of the most heavily used financial benchmarks in the world. In fact, currently over $300 trillion in contracts reference it. Banks and other financial institutions monitor LIBOR rates closely, and rises and falls in LIBOR rates often affect the interest rates on many banking products such as savings accounts, mortgages and loans. Despite its popularity, LIBOR's days may be limited.

LIBOR has come under scrutiny since several large banks allegedly rigged their daily rates. As a result, the requirement was imposed that banks must base their submissions for LIBOR rates on actual market trades. Further issues with the use of LIBOR do not stem from purposeful manipulation, but rather the reality that money market borrowing that underlies U.S. dollar LIBOR submissions has declined. As stated by Federal Reserve Governor Jerome Powell, "It is difficult to ask banks to submit rates at which they believe they could borrow on a daily basis if they do not actually borrow very often." Manipulation and shrinking data upon which LIBOR relies has made the foundation for this benchmark shaky.

The party largely responsible for putting LIBOR on the chopping block is the Alternative Reference Rates Committee, or "ARRC." The ARRC was created in 2014 by the Federal Reserve in response to the Financial Stability Oversight Council's and Financial Stability Board's requests for the identification and development of alternative interest rate benchmarks anchored in observable transactions and supported by appropriate governance structures. Once convened, the ARRC determined that the financial markets may be better served by one of the following alternatives to LIBOR: Overnight Bank Funding Rate, or "OBFR," or an overnight Treasury general collateral repurchase agreement rate, or "GC Repo."

OBFR is calculated as a volume-weighted median of overnight federal funds transactions and Eurodollar transactions reported in the FR 2420 Report of Selected Money Market Rates. General collateral, or "GC," is the range of assets that are accepted as collateral by the majority of intermediaries in the repo market, at any particular moment, at the same or a very similar repo rate – the GC repo rate. The ARRC feels that these alternatives are more firmly based on trades from robust underlying markets and comply with the latest international standards.

Whether OBFR, GC Repo, or some other alternative benchmark replaces LIBOR remains to be seen, but it is important to monitor the issue and adjust lending practices if necessary.

Credit Risk Certification (CRC)

Why CRC?

In today's rapidly changing financial services industry, you need practical, day-to-day knowledge that will help you excel in your profession. You need the latest skills—skills that are current and complete. And you need the demonstrated ability to serve a diverse base of clients. Plus, you need all of your knowledge, skills, and abilities to be validated by a respected organization like RMA.

For more information, visit http://www.rmahq.org/crc.

Credit Risk Management Audio Conference Series

October 11, 2016: Concentration Risk Management

November 8, 2016: Small Business Lending Challenges

Time: All audio conferences will be held at 1:00 p.m. Eastern Time (10:00 a.m. Pacific Time).

Fees*

RMA Associate members: $120 for each audio conference (per phone line).

RMA Professional members: $130 for each audio conference (per phone line).

Nonmembers at RMA member institutions: $130 for each audio conference (per phone line).

Nonmembers: $180 for each audio conference (per phone line).

*Additional listeners cost $0.

Visit www.rmahq.org for the complete list of upcoming Credit Risk Management, Enterprise Risk Management (ERM), Operational Risk, and Regulatory Audio Conferences.

Lunch and Learn: Real Estate Lending – What Me Worry?

Real estate lending is attracting more attention from clients, the regulatory community and the public. For an update on real estate lending issues, from concentrations to high volatility commercial real estate (HV-CRE), the Hampton Roads RMA Chapter is delighted to welcome back Dev Strischek, SVP and Senior Credit Policy Officer for SunTrust Bank! Dev will present at our Lunch & Learn session on January 19, 2017 (12 PM to 1:30 PM.)

About RMA

Founded in 1914, The Risk Management Association is a not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA promotes an enterprise approach to risk management that focuses on credit risk, market risk, and operational risk. Headquartered in Philadelphia, Pennsylvania, RMA has 2,500 institutional members that include banks of all sizes as well as nonbank financial institutions. They are represented in the association by more than 18,000 risk management professionals who are chapter members in financial centers throughout North

Mission Statement

RMA is a member-driven professional association whose sole purpose is to advance sound risk management principles in the financial services industry.

Why should you join?

RMA helps our members use sound risk principles to improve institutional performance and financial stability, and enhance the risk competency of individuals through information, education, peer sharing, and networking.

Our chapter presents opportunities for individuals to get involved. Chapters rely on the talents of volunteers to stage many of their programs, conduct membership development efforts, and promote the ideals of the Association. To find out more about how you can get involved in our chapter, email Jeanne Ali at jeanne@associationbuilders.com. If you are a college student or know of one who might be interested in joining, visit www.rmahq.org/studentmembership.