The Transformation of Lending

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March 2015

The financial services industry has undergone significant change in the last five years. Lenders in the industry have traditionally been banks, insurance companies, Real Estate Investment Trusts (REITs), brokerage firms, mortgage bankers, government agencies, and securitization conduits. When we say "traditional lenders," we mean consumer and commercial originators in all sectors. Since the 2008 - 2009 recession, the industry has seen a significant falloff in originations from traditional lenders and a number of new entrants.

New lending sources include, but are not limited to:

- additional authorities at state and federal government agencies
- lending expansion at existing government agencies
- credit unions
- private equity firms, and
- the shadow banking system (meaning non-bank financial intermediaries that perform certain banking functions, including lending).

Let's look at the table below to consider some of the aforementioned parties:

Lending Product	2008 Primary Originators	2015 Primary Originators
Home Loans (conforming)	• Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) • Federal National Mortgage Association (FNMA or Fannie Mae) • Federal Housing Administration (FHA) • Banks	• FHLMC • FNMA • FHA • Credit Unions • Other Government Agencies
Home Loans (jumbo)	• Banks • Private Securitizations	• Banks • Credit Unions • Private Equity Firms • Wall Street Brokerage Firms • REITs • Shadow Banking
Consumer Debt	• Banks • Private Securitizations	• Credit Unions • Private Equity Firms • Shadow Banking • Banks • Government Agencies
Commercial & Industrial	• Banks	• Credit Unions

Lending Product	2008 Primary Originators	2015 Primary Originators
		• Collateralized Loan Obligation (CLO) Securitizations • Private Equity Firms • Government Agencies
Agricultural	• Banks • Government Agencies	• Banks • Government Agencies • Foreign Banks • Other Government Agencies

While not a complete listing of lenders for either period, this table demonstrates what is happening in the lending markets on a high level. As illustrated in the chart, government agencies and credit unions are increasing lending in many areas, and shadow banking is now occurring in certain product types.

Let's highlight some of these originators and discuss why there has been so many changes in the originator landscape.

The primary cause for the change is tighter lending standards by almost all banks, largely resulting from tighter regulatory guidelines in not only credit underwriting, but also in compliance and levels of interest rates. Most banks today would not make the same loan originated in 2008 without a significant increase in credit guidelines, increased compliance procedures, and a lesser rate (with respect to spreads to Treasuries) due to fair lending changes and the overall opportunities in the marketplace.

Credit Unions

Credit unions benefit from significant regulatory changes since 2008 that increase their potential customer base and the level and type of lending permitted (for example, credit unions can now originate commercial real estate and commercial and industrial loans). Credit unions continue to be exempt from any federal or state income tax. The average credit union can thus charge less on loans and pay more on deposits since there is no income tax expense, which approximates 38 - 40% of net income for most banks and insurance companies. Consequently, the credit union percentage of the deposit and lending markets has increased considerably in the last five years.

Government Agencies

Government agencies continue to take a larger slice of the lending pie even after the potential bankruptcy of FHLMC and FNMA:

- The FHA now offers a zero down payment residential real estate loan, and a total of 142 different government agencies (attributed to "The Garrett, McAuley Report" authored by our friend, Joe Garrett) now originate residential real estate loans

- The Small Business Administration and the USDA (for rural areas and cities less than 30,000 in population) continue to be a force in the commercial real estate and commercial and industrial loan sectors. Their rates are generally higher than the private sector, but their amortization levels are considerably longer, providing the customer with a smaller monthly loan payment. These agencies also loan to customers who cannot find conventional financing, so the agencies provide a valuable service to a portion of the customer base

- The government now originates 100% of the federal student loans

- Government agencies originate a large majority of agricultural land loans, as well as loans on homes, buildings, and equipment in rural areas.

Private Equity Firms

Private equity firms are directly originating consumer loans, jumbo residential real estate loans, and commercial loans. In the past, such firms typically invested in originators or purchased securitized product.

Shadow Banking

Shadow banking lenders are originating the niche and riskier loans in the consumer equipment, commercial equipment, jumbo residential real estate, and commercial real estate markets. This opportunity for shadow banking lenders results from prior lenders such as banks and insurance companies leaving these arenas due to regulatory or credit risks.

In summary, banks face much more competition from new lenders. The increased regulatory burden placed on banks compared to these new originators allows these new competitors to increase volume. In the past, the regulatory burden eased after a period of increased regulatory focus. However, it is unclear what will happen in the next few years given the current climate in Washington, DC and the state capitols. Banks will need to focus on niche markets for new loans and concentrate on fee and gain on sale income from servicing and sales of loans in the commercial and residential lending markets.