Homework on student loan refis pays off for SouthEast Bank

By **Allison Bisbey**

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Doing the homework paid off for SouthEast Bank.

The $1.4 billion-asset community bank based in Knoxville, Tenn., garnered a triple-A from two credit rating agencies, S&P Global Ratings and DBRS, for its inaugural securitization of loans refinancing the debt of borrowers with advanced degrees and high-paying jobs.

By comparison, Social Finance, which started lending in 2012 and did its first student loan securitization in 2014, didn't get a triple-A rating until 2015. CommonBond, which started lending a year later, did its first triple-A deal this year. Earnest achieved a triple-A only after being acquired last year by Navient, a financial institution with a much larger balance sheet and longer servicing record.

It didn't hurt that rating agencies – and asset-backed investors – are already familiar with SouthEast Bank's parent company, EdSouth, which is a regular securitizer of federally guaranteed student loans.

But Barbara Thomas, SouthEast Bank's executive vice president and head of its Education Loan Finance (ELFI) division, also credits the build out of the student lending platform over the past year. "We're not an unknown entity; people are very familiar with the name, but this is a new product under that name," Thomas said. "We are incredibly proud of getting a triple-A right out of the gate. No other refi student lender has done that. We did it right."

Two senior tranches of notes were issued in the $200 million transaction, which priced this week; a floating-rate tranche with a weighted average life of 3.55 years pays 75 basis points over one-month Libor and a fixed-rate tranche with a weighted average life of 3.75 years pays 73 basis points over swaps.

A subordinate tranche with a weighted average life of 5.97 years and a single-A rating (from DBRS alone) pays 165 basis points over swaps.

“There was a liquidity premium compared with where other competitors would have priced if it came to market at the same time, but it [the premium] was not that substantial,” Thomas said.

“I’m so happy with the depth and breadth of the investor base,” she added.

SouthEast Bank started offering refinance student loans in December 2015 and it initially outsourced origination. In 2016, the bank hired Thomas, who formerly managed the student loan banking group at Morgan Stanley. Over the past year it has brought origination in-house, with a state-of-the-art loan application platform and personalized customer service – a borrower works with the same representative throughout the refinance process.

Thomas has a deep background in student loans. While at Morgan Stanley she advised on over $75 billion of financing for clients including SoFi, CommonBond and Laurel Road (formerly Darien Rowayton Bank), all of which are now competitors. But her involvement predates the development of refinance lending. In 2008, she was appointed as lead advisor to the U.S. Treasury and the U.S. Department of Education in the development and execution of the $40 billion Straight A Conduit Program to fund the student loan industry during the credit crisis, according to her LinkedIn profile.

“I grew up in the industry and I learned all of the lessons,” Thomas said. “My fingerprints are everywhere.”

In its presale report, DBRS cited the experience of ELFI’s management team, as well as that of EdSouth, the deal’s administrator, as credit strengths. EdSouth currently administers over $2.6 billion of Federal

Family Education Loan Program (FFELP) loans across 15 trusts and has financed approximately $5 billion of federal student loans since 2011.

The new transaction, ELFI Graduate Loan Program 2018-A, securitizes the bulk of the $250 million of refinance loans that the bank has made to about 3,455 borrowers since launching its two refinance products, one for borrowers with advanced degrees, high credit scores and high incomes and the other for parents. Having access to the capital markets allows SouthEast to accelerate the pace of refinance lending, even if the bank doesn't have to rely on it.

"I went through the credit crisis," Thomas said. "I know there are times" the securitization market "won't be there. That's why having a bank balance sheet is so attractive."

Like any first-time issuer, the bank fielded a lot of questions about whether it plans to be a programmatic issuer, particularly since it does have a number of funding outlets – including whole loan sales.

"We do plan to be a programmatic issuer, just as we are in the FFELP arena," Thomas said. "We're in the student lending market for the long run, because we've been in it for a long time."

And while there's plenty of competition for borrowers, just as there is for personal lending, "our biggest competition is inertia," she said.

"The average borrower has six to eight loans with different terms. It's very complicated, and they don't want to deal with [another loan]. They think the process is more cumbersome than it is."