When less is more

Smaller branches and sale-partial leaseback options can help banks keep a brick-and-mortar presence in communities in a more cost-efficient way.

BY WILLIAM YEOMANS

Over the past 15 years, the way banks interact with their customers has gradually shifted, with more and more transactions being completed online and through mobile devices. The COVID-19 pandemic accelerated this change, reducing in-person transactional activity and prompting banks to rethink the functionality of their branches.

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Traditionally, bank branches were designed for high volumes of retail and business transactions, requiring spaces of 4,000 to 6,000 square feet. Today, branches don't need to be so big—and banks are acting accordingly. The [average size of a new bank branch] today is about 2,500 square feet.

To reduce costs and improve the customer experience, banks are exploring ways to downsize, right-size and restructure their branches to create smaller, more flexible spaces that are better suited to the needs of modern consumers. New options are emerging, along with an old approach with a new twist: sale-partial leaseback. The new sale-partial leaseback approach creates more competitive advantages, future optionality and operational benefits for many banks.

In a sale-partial leaseback, banks sell their branches to specialized real estate management companies and then lease back a smaller portion of the building for their operations. This allows banks to maintain their presence at an established location while lowering their cost, realizing non-dilutive capital and reducing their branch footprint. In addition, leasing the bank's vacated space to third parties creates cost-sharing opportunities and can drive more traffic to the location.

A "less is more" approach, coupled with a sale-partial leaseback strategy, could prove to be the future of the bank branch. The approach creates more capital and reduces long-term expenses while providing a better customer experience and enabling a renewed focus on the core banking business. The result is increased earnings and stock prices for banks.

WHY BRANCHES STILL MATTER

Despite the decline in branch size, branches still play a critical role in the banking industry. They're an important source of revenue for banks and a crucial component in building relationships with customers. Because of this, banks have been rethinking the traditional branch model and experimenting with new, innovative approaches, including branchless banking, pop-up branches at high-traffic locations and high-tech smart branches.

Some banks are innovating by creating "multifunctional" branches that serve as community hubs. In one high-profile example, some Capital One branches offer a range of services beyond traditional banking, such as coffee shops, coworking spaces and meeting rooms. This allows banks to build deeper relationships with their customers and offer a more complete experience.

This is exactly what the market wants, according to a study by Deloitte: "Our survey indicates that consumers will continue to use digital channels for simple transactional activities, but many consumers desire high-touch interactions for more complex products and services, such as mortgages and financial advice."

In many ways, a customized and community-tailored version of Capital One's approach seems like a perfect fit, including for smaller, regional and community-oriented banks. And these smaller banks can probably do it even better because they know the communities.

Over the past several years, BMO Harris Bank has been experimenting with smaller branches and technology-based solutions, including building multifunctional branches. A sale-leaseback

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program has allowed BMO Harris to free up capital that can be invested in these initiatives while still maintaining a physical presence in the community.

Other banks, such as Wells Fargo and Truist, have also used sale-leaseback options to reduce their branch footprint and free up capital for other initiatives.

LESS IS REALLY MORE

This may be the perfect time for banks to embrace the "less is more" strategy to build a successful future. Using a sale-leaseback strategy, nearly all banks can move quickly and create competitive advantages right away.

"Our first sale-leaseback portfolio transaction immediately reduced our operating expenses and enabled the redesign of the oversized branches' space to fit our needs," says Jon Burk, vice president and senior portfolio manager at BMO Harris Bank. "The second and third portfolio transactions enabled further cost savings, branch space right-sizing and a step-up capital gain, meeting BMO's financial objectives."

For example, BMO sold its branch in West Bend, Wisconsin, in 2018. After the sale, the bank leased back approximately 50% of the building, leaving the rest available to third parties. Since the sale, the bank-vacated space has been leased to two not-for-profits and two commercial tenants, thereby creating positive synergies for both the location and the community.

The COVID-19 pandemic, alongside a tougher economic environment, has accelerated the trend toward smaller, more efficient bank branches. As more customers turn to digital banking options, banks are experimenting with innovative branch designs and technology-based solutions to meet changing customer needs.

Regional and smaller banks are particularly well positioned to take advantage of this trend and stay ahead of the competition. By embracing technology, implementing smaller branches and considering sale-partial leaseback options, banks can provide a more efficient and personalized banking experience while still maintaining a physical presence in the community. Moving quickly to make these changes may provide competitive advantages for banks looking to stay ahead in a post-pandemic and digital-first world.

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