BANKING UPDATE FOR THE 3Q

by Steve Brown

The 3Q is officially in the record books and the picture was certainly less than rosy. Some of the most interesting highlights were as follows:

Industry earnings: fell nearly 25% from a year ago, sinking to the lowest level in 4Ys. Overall, softness was driven primarily by higher credit losses and lower trading revenue. It is interesting to note, however, that most of the decline was attributable to 10 large institutions that accounted for more than 50% of the decline in industry earnings. Amazingly, the number of unprofitable institutions jumped 46% YOY, reaching just over 10%. Noninterest income slipped 5% from the same period last year, marking the first drop in the prior 12 quarters. Noninterest expenses climbed nearly 7%.

Return: ROA for the 3Q quarter dropped to 0.92%, the lowest level in 15Ys. ROE dropped 18% from the same period last year, slipping to 10.52%.

NIM: Interest-earning assets climbed nearly 8% from a year ago, as NIM benefited from a steeper yield curve. Overall, the average NIM was 3.36%, up from 3.34% in 2Q, but remained near 17Y lows.

Loans: Fire sales were common for the industry during the quarter, as total sales resulted in a net loss. This is the first time in 7Ys that a loss on sale has been recorded. Meanwhile, RE construction/development loans saw the smallest growth increase in 3Ys. Despite the slowdown, at the end of 3Q, about 25% of banks reported construction loan portfolios in excess of 100% of capital. Asset growth slowed sharply, coming in at 8.11% for the quarter vs. 9.84% thru 3Q 2006.

Loan Losses: Loan loss provisions swallowed up 11% of net operating revenue, doubling over the same period last year and soaring to their highest quarterly level in 20Ys. Overall, reserves increased 12% over the 3Q of 2006. The percentage of net charge offs to loans soared nearly 40% during the quarter, rising to the highest level in 5Ys (0.50%). Meanwhile, the largest increase occurred in C&I, where charge-offs were 91% higher than a year earlier.

Noncurrent: Delinquent loans had their largest quarterly increase in 20Ys, driven by construction/development (up 46%), soft residential real estate (up 24%) and home equity lines of credit (up 27%). Overall, the noncurrent rate was 1.08% at the end of the 3Q, the highest level in 4Ys.

Funding: Deposits were hard to find, leading bankers to significantly boost reliance on wholesale funding during the 3Q. Domestic deposits grew a mere 0.7%. The mix was tilted toward time deposits (up $82B) and other interest bearing liabilities (up $20B); and sharply away from noninterest bearing (down $53B). Meanwhile, funding gaps were filled aggressively with FHLB Advances, which soared $162B. Of interesting note, 15Ys ago domestic deposits funded 72% of industry assets, a number that has fallen to 53% as of the latest quarter.

M&A: 42 new banks opened for business during the quarter, while 93 were absorbed. For the year, 131 new banks were chartered, while 247 were absorbed and 2 failed.

Derivatives: Responding to competitive pressures to originate long-term fixed rate loans, but facing a funding base driven by short-term maturities, 1 in 8 institutions reported derivatives holdings at the end of the 3Q.

BANK NEWS

M&A

Premier Financial Bancorp ($549mm, WV) will acquire Traders Bankshares, Inc ($106mm, WV) for $18.1mm, or about 1.5x book.

Fed Talk

While not as compendious as Vice Chair Kohn, Bernanke's points were similar Â– the Fed will stay "alert and flexible" to deal with the "fresh wave of investor concern." In other words, look for another 25bp ease on Dec. 11th.

CRE Data

Our CRE data for Oct. is showing a faster decline than expected. NYC now has the highest vacancy rate for office buildings (at 7.6%) in some time. Meanwhile, non-accurals at many banks have jumped 40+bp and cap rates are ratcheting up quickly. Normally, we see about $75B of building sales under contract, but Oct. looks like it averaged around $15B. New loan spreads have increased 21bp for the month with about 50% of our data collected.

Wells Fargo

The Bank will set aside an additional $1.4B to cover anticipated losses on home equity loans.

Mobile Growth

BofA said that, after 6 months, its Mobile Banking service has reached a record 500,000 active mobile customers. According to a recent report, that's more than all other US banks combined.

Spending Planner

Chase Card Services has unveiled its Holiday Spending Planner, a free online budgeting tool that will help shoppers avoid overspending this holiday season.