DON'T WAIT TO TAKE ACTION

by Steve Brown

William Prescott, a commander at the Battle of Bunker Hill, is credited with the famous saying "Don't fire until you see the whites of their eyes." He was referring to our brethren in red coats from the U.K. visiting our shores way back when. While community bankers may feel they are indeed at war with the credit markets, waiting until you see the whites of your enemy's eyes may be too late. This is particularly true for those banks with an upcoming regulatory examination.

Recall that back in December of 2006, regulators came out as a unified voice with a no-nonsense notification to all bankers. In it, regulators told bankers that concentrations in commercial real estate would require additional tracking, reporting, strategic planning and risk management processes to pass muster. Regulators clarified that they were not telling bankers they could not be concentrated in CRE - just that those who chose to do so would need to ramp up oversight and diligence substantially.

Last week, the FDIC issued a letter reemphasizing the importance of strong capital and loan loss allowance levels and robust credit risk-management practices for institutions with CRE concentrations. The reminder was so formal, it's clear the regulators are seeing a substantial rise in loan portfolio risk in banks they have examined in the past few months.

Within the same notification, FDIC Chair Sheila Bair added additional commentary, stating "Although commercial real estate lending can be a profitable business line for banks, it is a good time to re-emphasize the 2006 guidance because a number of banks have significant CRE concentrations, and the weakness in housing across the country may have an adverse effect on those institutions. Banks with CRE concentrations should take steps to strengthen their overall risk-management framework and maintain strong capital and loan loss allowances. We encourage institutions to continue making commercial real estate and construction and development loans available in their communities using prudent, time-tested lending standards that rely on strong underwriting and loan administration practices." You can download the FDIC letter by following the "FDIC Letter" link in our related links section at the bottom of this page.

If you are a community bank about to be examined by the FDIC (or any other examiner for that matter), make no mistake that the lines have been drawn and you will be closely scrutinized. The regulators are not messing around with banks that have concentrations and having a pro-active risk management process consistent with the 2006 CRE Guidance and ALLL Joint Policy Statement is an absolute must.

Regulators are trying to be as clear as they can be. Banks with CRE concentrations should proactively downgrade credits; monitor risks; report to the board frequently; maintain a strong capital level; ensure loan loss reserve allowances are strong and well documented; manage loan portfolio risk as well as individual loan deterioration; ensure the strategic plan addresses the risk level and provides access and consideration for ways to boost liquidity; ramp up the workout process and reporting; ensure policies are in place to specifically address how the bank will handle OREO. You are also welcome to join us for an informational session by following the "BIG Events" link at the bottom right of this page. The Webex is titled UPDATE - FIL 22-2008 - Managing CRE in a Challenging Environment, which can be found under the "Event Center" tab.

BANK NEWS

M&A

Liberty Financial Services ($87mm, SD) will purchase Valley Bank ($75mm, SD) for an undisclosed sum.

Correction

On Friday we ran Valley National Bank ($12.7B, NJ) purchased Greater Community Bancorp ($974mm, NJ) for $167.3mm, or about 1.8x book - not the other way around as originally printed. The deal was struck after Oritani Financial Corp. ($1.3B, NJ) stated that it would not go through with its previously announced purchase of Greater Community.

Delinquency Review

Analysis by S&P finds the worst performing mortgage sectors over the past 12 months were subprime loans pooled in 2005. The delinquency rate for these loans is running at 34%. Other sectors also under stress include HELOCs (which have jumped 7%), closed-end home equity loans (up 12%), Alt-A (up 18%) and prime jumbo loans (also up 18%).

Technology

Banks might be interested in a recent study that finds the finance industry typically has 1 person in IT for every 16 employees. Meanwhile, banks wondering how well they are doing should know that the industry will spend 10.5% of revenue on IT this year, up from 8.3% in 2007.