

## POKING AROUND AND LISTENING

by [Steve Brown](#)

People poke all kinds of things into their ears. From fingers, to Q-Tips to peanuts and buttons, people put all kinds of things into their ears in an effort to clear out the passageway so they can hear things better. While we don't recommend either peanuts or buttons, we do recommend poking information in them now and again. We spend all day listening and talking to community bankers and experts alike and thought you might find the following information we recently heard about interesting.

In a speech given just the other day, the head of the OCC said he expects bank failures will rise, as commercial builders struggle to repay loans in coming quarters. He reiterated that more than 33% of community banks have commercial loans in excess of 300% of capital and 30% have more than 100% of capital in construction and development loans. If you wonder why examiners are so sensitive about this data, consider that when bank failures were spiking in 1987, the CRE number was only 175%. Is it any wonder regulators are cracking down on risk management and loan concentrations at banks these days?

We ran a quick story yesterday citing Robert Shiller, professor of economics at Yale and co-founder of the S&P Case/Shiller house index. In it, we reported he expected home prices to drop more than the 30% that happened during the Great Depression. What we did not indicate is that we are only down about 15% so far from the demarcation point he was referring to (i.e. about 50% of the way there). If he is right, it looks like the housing and construction sectors unfortunately have more pain to come.

Some bankers may have missed recent activity in the land acquisition and development sector. In an effort to get out from under its inventory, home builder Centex recently sold 8,500 lots in 11 states at 30 cents on the dollar. In November of last year, home builder Lennar sold 11,000 lots at 40 cents on the dollar. In just the ensuing 3 months between these sales, land prices eroded roughly 25%. Banks with land loans on the books should be aware that liquidity is extremely scarce and analysts predict housing construction will not rebound until probably 2010.

An old term has also been dusted off from the days of the S&L crisis of the 80's and 90's. That term is "performing nonperformer" and it refers to loans that are current, but weakness is evident (i.e. property values are declining, developers are using interest reserves to make payments on projects, advance amount to collateral value is rapidly rising, etc.). Regulatory scrutiny is running high on performing nonperformers (particularly on residential construction and land portfolios), which is leading to additional downgrades and increased loan loss reserves.

On the good news front, the slowdown in housing has been great for the multifamily sector. Projections now indicate rents on apartments will rise 5.3% this year, compared to 3.1% in 2007. In San Francisco, a city with limited capacity, swelling numbers of renters have pushed apartment rents up 14.6% in the 1Q alone. The national vacancy rate for rental housing was 9.6% at the end of 2007, a 6% decrease over the past 4Ys. Multifamily looks like it will remain strong, as people rent because they can not longer get loans, they are waiting for home prices to fall further and home foreclosures continue to surge.

In even more good news, there are still plenty of lending opportunities for community bankers focused on small business customers. In fact, a recent survey found 39% said it was becoming more difficult to get credit, up from 26% at the end of last year. Community banks should consider widening spreads on some of these loans, since options from conduits and larger banks have waned. Many clients tell us they have been able to improve pricing by as much as 50pb due to a lack of competition in the marketplace.

Opportunities abound for community bankers with their ear to the ground, but prudence is warranted and care must be taken to choose the best ones.

## **BANK NEWS**

### **Bankruptcy Surge**

The latest data shows Chapter 11 business bankruptcies climbed 16% in the 1Q.

### **OD Protection**

An important CA court case ruled the bank overdraft protection programs do not violate Truth in Lending laws. It was previously alleged by WAMU customers that OD programs create a credit agreement and are thus subject to the laws. The court ruled that if the bank routinely or automatically provided protection; that is not sufficient to imply a contract.

### **In-store Branches**

TCF (\$16B, MN), a bank that has one of the largest in-store branch networks (making up more than 50% of their branches) announced that it will close 12 of its 244 supermarket branches due to lower profitability.

### **SunTrust**

Announced a 44% drop in 1Q earnings due to a 10-fold increase in ALLL associated with the softening GA and FL housing markets. In order to shore up capital levels, the bank also said it looks to liquidate \$1B in Coca-Cola equity holdings.

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