

FLYING HIGH

by [Steve Brown](#)

The bald eagle is an interesting animal. It can fly as high as 10k feet, is a good swimmer and dates back some 25mm years in evolution. Those reasons and the fact that the birds symbolized power, strength and freedom, were primary catalysts why Congress adopted the eagle as our official national symbol back in 1782.

As with the bald eagle hunting for prey and given that things are changing so rapidly in the banking industry, we thought our readers might be interested in getting a bird's eye view.

The House voted yesterday on a housing bill that included a rescue for FNMA and FHLMC, which is good news. FHLMC's stock price had fallen about 72% over the past year, while FNMA's had slipped about 65%. When you consider that with Countrywide out of the picture, these companies provided liquidity to roughly 80% of all mortgages issued in the 1Q, the bailout could not have been avoided if things are to get any better. Unfortunately, there is more to go, since housing has not yet hit a bottom, so further delinquencies and volatility are likely.

It is also interesting to note that just a few months ago, experts were estimating 100 to 150 banks might fail over the next few years. As market conditions have worsened, recent updates find some now predicting a number as high as 300. While that number is disconcerting, it is important to note it remains only a prediction at this point and that it is also a far cry from the more than 1,600 banks and 1,000 thrifts that failed in the 80's and 90's. For those interested in knowing, the 10 largest financial institution failures in U.S. history were: #1 Continental (IL, 1984, \$40B); #2 IndyMac (CA, 2008, \$33B); #3 First Republic (TX, 1988, \$32.5B); #4 American Savings (CA, 1988, \$30B); #5 Bank of New England (MA, 1991, \$21.7B); #6 MCorp (TX, 1989, \$18.5B); #7 Gibraltar Savings (CA, 1989, \$15B); #8 First City (TX, 1988, \$13B); #9 Homefed Bank (CA, 1992, \$12B) and #10 Southeast Bank (FL, 1991, \$11B).

Another interesting sight to see relates to the world's largest banks and brokerage firms. So far, they have disclosed \$447B of credit writedowns and losses and raised more than \$331B in new capital. Of particular interest to us, Washington Mutual (the country's biggest thrift), is still dealing with \$15B of subprime loans, \$40B of hybrid ARMs, \$56B of option-ARMs and \$63B of home equity loans / lines of credit according to analysts. WAMU has seen its stock fall 86% over the past year as it struggles to get a grip on its issues.

Also of interest, as the 2nd half of tax rebates flow into consumer hands in the next few months, economists are adjusting growth projections. The latest survey finds 45% of economists believe the economy will slide to a 1% or lower GDP in the last 6 months of the year. In a crazy dance, the same survey found about as many economists feel GDP will do even worse and come in negative for the year, as those who think it will break through 2% and perform better (about 10% of those surveyed). We'll have to wait and see, obviously, but it is likely the economy will need more time to fully recover.

Home prices have retrenched in many areas to levels not seen since 2004. While that is a big drop, they will probably need to drop another 20% or so, before we reach the bottom of the cycle. Banks

selling foreclosed homes are finding they have to discount these properties an average of 87% of the time, while homes sold at auction recoup about 60 cents on the dollar on average.

Banks are increasing loan loss reserves. Data shows that right before the last recession (2001), the average bank had a loan loss reserve ratio of 1.50. Given market stresses, bankers have been boosting theirs once again. As long as banks are below this number, they will probably be encouraged by regulators to increase reserves.

As with the bald eagle, community bankers continue to soar through this latest credit crisis. It isn't over, but focusing and scanning the horizon for obstacles before they arrive will ensure your bank remains strong.

BANK NEWS

Housing Bill

Late Wednesday, the House of Representatives authorized Treasury Secretary Paulson to extend an unlimited line of credit to Fannie and Freddie with few restrictions. The President has retracted a veto threat against the bill and the Senate will vote on the measure by early next week.

Alternatives

Banks are missing opportunities to service their small business customers, according to a new study. In it, 87% of applicants rejected for small business loans were not given suggestions on how to improve their credit or provided an alternative. In addition, 69% wanted feedback they did not get and said they would consider other financing alternatives if they were offered by their financial services provider.

Small Biz

Despite the current negative press about banks, a new survey finds over 75% of small businesses say banks remain their most trusted source of capital.

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