OPENING CEREMONIES

by Steve Brown

Today kicks off the opening ceremonies for the 2008 Beijing Olympics. Festivities begin inside the "Bird's Nest" National Stadium and athletes from around the world will represent their countries, as they get ready to compete.

We have been traveling around doing plenty of talking to bankers and regulators these past few months and we are here to tell you everyone seems to feel like they have been carrying Olympic-level stresses. Things are rough right now in the industry and concern is running high as we all await compiled 2Q call report data. As we wait, let's recap.

Earlier this week, the FOMC left the Fed Funds rate unchanged at 2.00%. That was the 2nd meeting in a row that the rate did not change and barring some disaster, we would expect the rate to stay flat through year-end. That is good for banks, as it adds liquidity to the system. Our only problem at this point remains a few large players that are still clogging up the CD market and paying ridiculously high rates. If they would stop the nonsense, rates could settle down closer to Fed Funds and banks could slowly improve their liquidity position. We think this will take some more time to work through the system, however things are settling down and funding costs should slowly improve through the end of the year.

Commodities are slowly improving. While it is still too early in the hurricane storm cycle to celebrate victory, it is important to note that oil prices have fallen about 20% from their peak and corn is down 30%. Gasoline prices are slowly pulling back, which will put more money into the pockets of consumers. Since consumers are 67% of the economic engine, this is a good thing.

A just released survey of lenders across the country finds 82% have tightened lending standards this year, 97% expect higher bankruptcies, 89% expect higher unemployment and 13% expect to see increased loan demand over the next 6 to 12 months. The data obviously shows things are expected to remain rough at least through the end of the year. By sector, lenders said they expected the most volatility to occur in construction, retail, real estate and leasing.

Another study by CB Richard Ellis finds the industrial vacancy rate (of supply available in buildings that are 100k square feet or larger in size) in the 2Q climbed to 11.0% nationwide, up from 9.8% at this point last year. Cities with the highest industrial vacancy rates were Austin (22.2%), Boston (19.0%), Stamford (18.9%), San Antonio (17.1%) and Phoenix (16.6%). Meanwhile, analysis of office vacancy rates for the 2Q (covers office buildings in the largest city within the metropolitan area) nationwide climbed to 13.6%, up from 12.6% at this point last year. Cities with the highest office vacancy rates were Detroit (24.5%), Dallas (21.4%), Central New Jersey (19.6%) and Atlanta, Cincinnati, Phoenix (all at 18.7%).

Housing still has a long way to go before a bottom will be found. As of July, the percentage of vacant housing available for sale or rent soared to 4.8% nationwide, the highest level in 33Ys. Meanwhile, some 9.6mm homeowners now owe more on their home than it is worth, an all-time high.

The construction sector continues to struggle. Over the past year, about 20% of residential developers nationwide have gone out of business. Delinquencies on construction loans for single family homes soared to 10.8% during the 1Q, compared to only 2.7% for the same period last year. Finally, pricing discounts are so extreme (the top 5 worst cities are Detroit, Pittsburgh, Toledo, Buffalo and Rochester), that people can buy homes for less than it costs to build them.

Commercial loan spreads are widening. Bankers are able to get wider loan spreads on new origination, now that conduits have disappeared. The liquidity crunch has led to fallout in commercial mortgage-backed securities, where securitization in the first half of 2008 fell to a 10Y low.

We don't know about you, but the distraction and spirit commonly found in the buzz of the Olympics will be a welcome change from banking industry and economic woes. We plan to enjoy the opening ceremonies tonight, so let the games begin.

BANK NEWS

Nasty Report

FNMA cut its dividend 80%, following its announcement of a 2Q loss that was 3x worse than analysts had been expecting. The mortgage giant boosted loan loss reserves by 16% over the 1Q as delinquencies surged.

M&A

Highlands State Bank ($51.3mm, NJ) has agreed to purchase Noble Community Bank ($35.5mm, NJ) for approximately $4.19mm, or slightly less than 0.75x book.

Cutting Back:

JPMorgan Chase has reportedly notified 150k customers that their home equity lines have been reduced or cut since March. The changes affect about 15% of customers carrying home equity lines with the bank.

Housing Sector

Home delinquencies through the 1Q of 2009 (the most recent period available) reached the highest levels on record. About 6.35% of homes loans had at least one payment overdue.

Muni Debt

Only 24% of state and local municipal debt sold in the first half of this year was insured; down from about double that level for the same period last year.