NOT BOUND TO PLEASE THEE WITH MY ANSWER

by Steve Brown

Today is William Shakespeare's birthday. Recognized as a playwright and poet, his body of work is considered the greatest in the history of English literature. Shakespeare is not only credited with writing 37 plays and 154 sonnets (poems); but was also an actor, an owner of a theatre and received a title of one of the "King's Men." It is this title and the King's fondness for him that reportedly led Shakespeare to write Macbeth in appreciation. While not in the same league as Shakespeare, the Federal Reserve held its own play (audio conference) recently for bankers, reminding all that even though "Fortune brings in some boats that are not steered," regulators were looking for a bit more out of bankers with CRE exposure.

The presentation began with a focus on the housing sector. The Fed shared some statistics with the group, including an update that indicated housing prices nationwide had slipped 30% from the peak, retrenching to levels not seen since Nov. 2003. Areas highlighted as being impacted the most severely included Phoenix (down 48%), Las Vegas (-46%), Miami (-43%), San Francisco (-42%), San Diego (-40%) and Detroit (-39%). The Fed also indicated that 20% of all mortgages are underwater.

Taking another approach in the presentation, the Fed focused on housing inventory overhang. While sales have improved modestly in recent months, regulators reminded bankers that the supply of new homes remains elevated at 11 months. On the good news front, when it comes to new supply pressures, it was noted that housing starts have fallen to the lowest level in 40Ys.

Regulators then refocused attention on land. The presentation highlighted that finished lot prices had fallen 50% from the peak and that low sales rates for developed lots were being seen across the country. Here again, regulators said they expected foreclosures to continue to rise, as the industry works through a 59 month overhand of supply (compared to a more normal 16 months). Regulators also pointed out that some areas had been hit particularly hard by the slowdown. They highlighted that Merced, CA had a 275 month supply of vacant developed lots; while Yavapai, AZ was saddled with 268 months overhang. Little can be done at this point to speed along absorption, but given extreme stress in some areas, banks are reminded to maintain a diligent watch on any customers that are developers. Unfortunately, this overhang problem with land could take years to finally work its way through the system.

There are many other areas of CRE lending that the Fed focused on, but some that caught our eye that we thought bankers may want to know included: less than 50% of AD&C loans have been reappraised since being underwritten; markets the Fed indicated had the worst vitality scores as of 4Q 2008 were Phoenix, Atlanta and Detroit; record-high vacancy rates are expected nationally in all 4 CRE sectors (Office, Industrial, Multifamily and Retail) as demand drops sharply; the national office vacancy rate is expected to balloon to 20.5% by 2010; office property values are expected to drop 36% from peak levels; and the average national cap rate is expected to rise to 7.25% by the end of this year. Contrary to media hype, the Fed expects CRE loss rates to remain relatively low over the next 3Ys. This is primarily a result of steady net operating income given lease and rent projections. Although declining values mean higher loss given defaults (if a default were to occur), stable property income means the probability of a default actually occurring is less likely to occur. We have just scratched the surface of this presentation, so we'll cover some more tomorrow.

In the meantime, this weekend, try to find a comfy chair and read one of Shakespeare's famous plays. Whether you decide on Romeo and Juliet, Merchant of Venice, A Midsummer-Night's Dream, Hamlet, Othello, Macbeth or King Lear; you will certainly find solace and enjoyment away from the hectic banking world. Everyone needs an escape now and again and one of the best at providing it was certainly William Shakespeare. We wish a Happy Birthday to Sir William.

BANK NEWS

M&A

Southern Missouri Bancorp ($455mm, MO) has agreed to purchase Southern Bank of Commerce ($30.5mm, MO) for an undisclosed sum. Southern Bank of Commerce is currently under an informal written agreement with banking regulators.

Transparency?

BofA CEO Ken Lewis testified under oath that he was pressured by Fed Chair Bernanke and Treasury Sec. Paulson not to disclose financial difficulties associated with the Merrill Lynch acquisition.

TARP Update

The Obama Administration said it is not likely that they will have to go back to Congress for an increase to TARP, as the amount of capital appears sufficient. However, only $135B is left and we are certain that the soon-to-be-released stress test results will require more than that. In related news, the Administration said they are considering allowing banks to repay their existing debt (and lowering the restrictions) and may convert the existing preferred TARP debt to common equity.

Economic Upturn

A WSJ poll finds economists think the recession could end as early as this Sep. For everyone's sake, let's hope so.

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