READING AND LEARNING

by Steve Brown

We don't know if someone gave you a Kindle or not this holiday season, but whether you read online or buy a paper every once in awhile, you are not alone. In fact, a recent study by Nielson finds 84% of college graduates read a printed (either online or off) newspaper at least once per week.

We read many periodicals, newspapers and other sources of information all day long, so we are admittedly much more active when it comes to reading than perhaps many people are. We find it a good way to stay on top of industry events. That is why we read with interest some recent information we came across from banking regulators. The data should be helpful to community bankers trying to figure out what to do in 2010, as we all try to close the door on a difficult 2009. Here are some of the findings that we thought might interest our readers the most.

Loan quality remains an issue for the industry. The latest data from the 3Q finds nonperforming assets have jumped 10% from the 2Q for the largest bank holding companies, a decent barometer of potential problems for all banks. For community banks specifically, nonperforming assets have climbed to 7x the level from the end of 2006.

Small businesses are under strain. While many have been able to reduce staffing, cut costs and otherwise survive, things are becoming more strained and worries remain elevated that more bankruptcies could be forthcoming unless sales increase. Unfortunately for the industry and the economy, small businesses rely on banks for 90% of their financing needs, compared to only 30% for large businesses. This stark difference means unless lending comes back online soon and the consumer starts to spend, 2010 could be another difficult year for community banks as they work through small business customer strains.

Fears are running high on the regulatory side of the fence that next year could be rough in particular for banks with CRE concentrations. Given that CRE loans represent 325% of reserves and 47% of all loans for the 8k+ banks across this country, it isn't any wonder that expectations of a downturn send shivers up the spine of the regulatory agencies. While capital ratios remain strong, weak loan quality, low earnings and high provisions are all taking a toll and adding strain to the industry.

It is time to get aggressive about loan restructuring. Banks should be very harsh when reviewing the wherewithal of customers to repay debt and not hesitate to restructure loans before they go bad. The regulatory agencies have provided guidance to help and examples are many in the documentation, so community bankers should be proactive to prevent ongoing portfolio weakness. Regulators have indicated that beginning in 2010, a comprehensive system-wide training initiative will be undertaken to boost both examiner and industry training about prudent workout strategies.

To get ahead of the curve, bankers should focus more effort on getting a good handle on cashflow and debt coverage than on LTV. While both are important, appraisals are not keeping pace with events or are too draconian in some cases, so cashflow is king. In the retail sector for instance, bankers should be closely focused on the impact of co-tenancy clauses (rent reduction if a certain occupancy is not achieved) and their impact on cashflow. Given that the typical retailer can only pay about 10% of gross sales in rent, with sales off 40% in some cases, lease restructures will be more common in

2010. Banks with retail exposures should "shock" for these potential events to ensure a debt restructure plan is at the ready should debt service coverage drop below 1.05x.

No matter how you are preparing for the upcoming year, flexibility will be important. As can be the case when reading newspapers, the stories will change over time and what is interesting today may not be of interest tomorrow. Community bankers that prepare, test, execute effectively and manage costs tightly until daylight appears stand the best chance of benefiting in such a difficult situation.

BANK NEWS

Gov't Aid

Attempting to calm investor nerves, the Treasury announced unlimited capital support for Fannie Mae and Freddie Mac for the following 3Y and a halt to MBS purchases from these companies.

Cash In Hand

According to Cardtronics, holding the largest ATM coverage in the world, total dollars withdrawn from ATMs for the period before Christmas tipped 8.5% higher than the same period last year and the number of transactions rose 7.9%.

Consumer Payments

A survey by the FRB Boston finds over 50% of consumers use credit, debit or prepaid cards for monthly bills. The debit card in particular is used more frequently than cash, credit cards or checks, and more people have debit cards. As for online bill pay, popularity is rising however it only accounts for 1 in 10 consumer payments. When selecting payment methods, consumes rank ease of use and security as the most important considerations.

Back On Their Feet

The OTS reports that the 2Q re-default rate on modified mortgages (60 days or more delinquent, 3 months post restructuring) fell from 30% to 19%.