

THE GROUND HOG'S LONG SHADOW ON HOUSING

by [Steve Brown](#)

The ground hog, also known as a wood chuck, is a mammal found throughout most of North America. They are a bit bigger than a cat, are primarily vegetarians, eat wild grasses and nuts, agricultural crops and the occasional bug or snail. Ground hogs are wonderful diggers and live in underground burrows. It is well known that the most important day in a ground hog's life cycle is each year on Feb. 2, when it emerges from its burrow to determine the medium-term weather outlook for the country.

This special day was immortalized in the 1993 film *Groundhog Day* starring Bill Murray. In the film, Murray's character Phil, a television reporter, despises one particular assignment over all others - the coverage of Ground Hog Day in Punxsutawney, PA. Due to his bad conduct while reporting the event, Phil becomes magically involved in a time loop in which he repeats the day he hates, until he makes personal and professional progress.

Because of the film, "Ground Hog Day" has become a metaphor for any unpleasant situation that seems to continually repeat itself. It has been used by groups as divergent as the military for the passing of each day on tours of duty, or ex-British Prime Minister Tony Blair quipping after a number of inquiries by political opponents.

Many bankers too, have felt they are living in a Ground Hog Day cycle of their own for a number of years now. We know the macro and micro economic aspects of this all too well, and no one will deny that the landscape of banking has changed forever.

Many banks began with the implosion of their loan portfolios, as even high-quality borrowers could no longer keep up with their obligations. Some would argue that the biggest part of the economic contraction has been in the housing sector.

Earlier this week, it was decreed by the economic intelligencia that the housing market had decisively turned. The evidence cited was 10 consecutive months of improvement in the Case Shiller Home Price Index, plus 6 year-over-year price increases. Indeed, with prices up in almost every metropolitan area, improvement is widespread and hopefully sustainable.

However, the depth of the housing contraction cannot be understated. Nationwide, home prices are still about 30% below their Apr. 2006 peak and prices are similar to where they were in Sep. 2003. This crucial part of the economy that drives so many others has taken so long to turn, that we celebrate prices that have only recovered to the level of 10Ys ago.

The consequences of what has happened to the housing market are multifaceted. Regulations have driven many small mortgage firms out of business and banks must comply with a far more complex set of rules. Most home loans are also consolidated with only a handful of big banks.

We've seen Fannie and Freddie go from implicit backing by the Federal government, to near bankruptcy, to pretty much full backing. We have seen mortgage rates driven lower and lower by the Fed, in an effort to spur the economy through refinancing. We have seen MBS and CMO's - the pillars

of bank investment portfolios - hit by low yields and high prepayment speeds, damaging returns. It has all added up to a significant challenge for community banks.

In the end, the film Groundhog Day is seen by many as a tale of self-improvement. No one will deny that the mortgage business had been frothy, with little consideration to either credit risk or fallout down the road. We have all learned some lessons. Let us hope that we really are moving toward the end of the housing market's Ground Hog Day.

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BANK NEWS

M&A

Fifth Third Bancorp (\$115B, OH) will buy the credit card portfolio from Quad City Bank & Trust (\$1.1B, IA) for an undisclosed sum.

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First Bancshares (\$724mm, MS) will buy First National Bank of Baldwin (\$190mm, AL) for an undisclosed sum after First National files Chapter 11 bankruptcy. First National is severely strained with leverage capital of only 2.2%.

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FIS will buy the 78% interest it doesn't already own in mFoundry, as it seeks to control more mobile banking and payments technology.

M&A Off

First California Financial Group (\$2.0B, CA) and Premier Service Bank (\$139mm, CA) have called off their previously announced merger, as the deadline has passed. First California originally agreed to buy Premier in Feb 2012, then in Nov 2012, agreed itself to be sold to PacWest Bancorp (\$5.5B, CA).

SEC Reporting

The law that allowed companies with less than 1,200 shareholders to deregister from SEC reporting has led 100 banks so far to stop, according to the Washington Post.

Less Optimism

A PWC survey finds only 33% of North American company CEOs were very confident in their revenue prospects in the next 12 months, a 21% decline vs. 2011.

Basel III LCR

The Liquidity Coverage Ratio (LCR) kicks in starting in 2015 through 2019 for banks. It is intended to ensure banks have enough liquid assets to cover net cash outflows for 1 month (denominator) with the most liquid assets (numerator). Liquid assets include unencumbered cash, central bank reserves and government guaranteed assets that are assigned a 0% risk weight. Government agency assets and high quality non-financial corporate bonds can also be included (up to 40% of the pool of liquid assets but only after being haircut down to 85 cents on the dollar). Agency MBS and CMOs are subject to the 40% limit and the 15% haircut.

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