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## Losses narrow at local banks, yet loans deteriorate

South Florida Business Journal - by [Brian Bandell](#)

Looking only at the improvements in the bottom lines of many South Florida banks in the first quarter, it might seem like local banking turned the corner. Yet, the deterioration of loan quality and the lowering of their reserves show a scenario of continuing strain on their finances.

Many South Florida banks are positioned to survive the recession and possibly rebound once the economy starts growing. Experts worry that a handful of local banks won't make it unless they can quickly raise capital or find a buyer. Among those are Miami-based **Republic Federal Bank** and Jupiter-based **Integrity Bank**, which both finished the quarter undercapitalized.

The 81 South Florida-chartered banks combined to lose \$540.9 million in the first quarter, a 40 percent improvement from their \$908.3 million loss in the fourth quarter, according to **Federal Deposit Insurance Corp.** data.

The results include **BankUnited** FSB, which was closed by federal regulators on May 21. Its assets were given to a new BankUnited, which will show up in the FDIC's second quarter report.

Even though BankUnited FSB's \$403 million loss in the first quarter made up the bulk of the combined losses, it wasn't alone in its troubles. Only 35 of the 81 South Florida banks were profitable in the first quarter. Still, that's an improvement from the 27 profitable local banks in the fourth quarter.

"The majority of these institutions are taking their medicine right now and, even if it's hurting their balance sheets, they are looking to improve in future quarters," said Carlos Arboleda, practice director of the banking and financial services group for recruiter **Stephen James Associates** in Plantation.

However, the banks that have put off taking a lot of charges to account for their ailing loan portfolios could suffer for much longer, he added.

The collective bottom line improved as banks took fewer charges related to problem loans, but that doesn't mean their loan troubles were any less severe.

South Florida banks held \$4.33 billion in noncurrent loans, or 7.49 percent of their total loans, as of March 31. That's up from \$3.53 billion, or 6.03 percent, at year-end.

Nationwide, the noncurrent ratio was 3.76 percent.

### **Lowering the bar**

Having a 1 percent noncurrent loan ratio used to be considered a red flag, but that would be a strong performer in this market. Of the 81 local banks, 61 had a noncurrent loan ratio greater than 2 percent. Of those, 17 had a ratio above 10 percent, led by Premier **American Bank** at nearly 22 percent.

"Having noncurrent loans in or near the 20 percent range, or one of every five loans, is shocking to say the least," Miami-based banking analyst and economist Kenneth H. Thomas said. "Despite all of BankUnited FSB's problems, eight local banks had noncurrent loan ratios greater than it as of the end of the last quarter .... Nearly one in four local banks have or are close to a double-digit noncurrent loan ratio, which would have been unthinkable a few years ago."

The skies on the horizon remain cloudy as South Florida banks had an additional \$1.73 billion in loans that were current, but between 30 and 89 days past due. That's up from \$1.65 billion in the previous quarter.

Loan problems are far from over, especially for commercial properties, said Mark Sunshine, president of Boca Raton-based First Capital, a commercial lending firm. Many commercial properties that were financed at the peak of the market based their debt service payments on rental rates that aren't realistic in this market. As those leases roll over and the landlords start collecting less, commercial properties will start missing payments, Sunshine said.

**BankAtlantic Bancorp** Chairman and CEO Alan Levan, who has experienced several boom-and-bust cycles in Florida, said the state's economy will come back and stem the tide of defaults.

"We are in a temporary decline of value," Levan said. "Growth will return in a dramatic way after the housing inventory is absorbed .... Then you're not dealing with desperate sellers and the market will bounce back, so the appraisals will go up."

As it stands now, the real estate appraisal is extremely difficult because most of the transactions that appraisers use as comparables are foreclosures, short sales or desperate sellers, Levan said. This impacts banks because they must appraise the collateral property tied to their noncurrent loans and their repossessed property and take charges to make up for the losses they expect to take when the property is sold.

“We recognize our losses as quickly as we can and reserve as much as we can,” Levan said.

BankAtlantic, the banking subsidiary of BankAtlantic Bancorp (NYSE: BBX), booked a reserve for future loan losses that covered about 47 percent of its noncurrent loans on March 31. For a South Florida bank, that’s well above average, although it trailed the national noncurrent loan reserve coverage ratio of 66 percent – the lowest it’s been in decades.

### **Reserves cover a fraction of bad loans**

In total, South Florida banks held future reserves for loan losses that covered 30.5 percent of their noncurrent loans on March 31, down from 37.8 percent at year-end. Of the 81 local banks, 29 had coverage ratios below 25 percent – a level that Thomas calls a “Category 5” alert.

“The very low reserve coverage ratios for our local banks and many others around the nation is troubling in many respects, not the least of which is the fact that their reported profits would be lower, or losses would be higher, if they were adequately reserved,” Thomas said.

It would take an additional \$1.54 billion in loan loss reserves to collectively bring South Florida banks up to the national average of 66 percent. However, taking such a charge would wipe out more than a quarter of their collective Tier 1 capital – the most crucial component of a bank’s books.

Some local banks would lose much of their capital and fall below regulatory capital requirements if they reserved for even half of their noncurrent loans.

Miami-based Premier American Bank held a \$13.9 million reserve to cover \$70.5 million in noncurrent loans – consisting mostly of the hard-hit sectors of construction and multifamily property mortgages. If the bank boosted the reserves for those noncurrent loans to cover half of them, it would wipe out Premier American Bank’s \$20.5 million in Tier 1 capital.

The bank was just above well-capitalized requirements on March 31.

“Premier American Bank is currently talking to investors and will be raising additional capital shortly,” Chairman, President and CEO Rolando Bichara said in an e-mail. “The increase in capital will mitigate the commercial real estate past dues which have increased our non current loan ratio.”

### **Banks’ revenue stream is worrying**

Even with all the troubles on the lending side, the sharp drop in banks’ net interest income – their revenue stream – is just as concerning, said Raul Fernandez, director

of business development at Coral Gables-based financial executive recruitment firm Nason and Nason and the former president of **Pine Bank**, which is now part of Republic Federal Bank.

As the Federal Reserve lowers interest rates, banks collect less interest income on their loans. Yet, they can't lower the interest they pay on deposits by a comparable amount because so many distressed banks are bidding up deposit rates to attract customers that will overlook their financial problems, Fernandez said. The combination of these factors narrows banks' net interest margin.

South Florida banks combined for \$416.3 million in net interest income in the first quarter, which was down 26 percent from the same quarter of 2008, when the recession was in its early stages.

Their net interest margin in the first quarter was a paltry 2.3 percent, down from 3.21 percent a year ago.

The interest-generating power of the banks also took a big blow from past due loans and repossessed property, with the latter category totaling \$383.4 million at South Florida banks on March 31. Local banks missed out on \$297.2 million in loan payments that they were due in the first quarter because borrowers didn't pay.

"With shortfalls in reserves, plus the constrained net interest margin, I believe banks will suffer through the end of the year," Fernandez said.