

More regulation for banks in 2010

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By: **Wayne Tompkins**

Ken Thomas recalls that at this time last year, the financial world had just come out of the Lehman Brothers collapse, and the economic crisis was at its peak. The world was in the middle of a deep recession, and the housing crisis seemed to have no end.

Heading into 2010, things are looking better - relatively speaking.

"Last year at this time, there was really little basis for optimism," said Thomas, an independent Miami banking analyst and Wharton School professor. "Now, there are enough signs to suggest that things will turn around. The recession is technically over. Housing will likely hit bottom in the middle of 2010, though the commercial real estate problems won't hit bottom until 2011."

The credit crunch will remain with us, Thomas said; getting a loan from any bank will still be a challenge; and even though the number of problem banks across South Florida will continue to mount, by the end of the year, some kind of corner will likely have been turned for area community banks, he said, though that seems destined to be one of the last sectors that will rebound.

"Banks are very much a lagging indicator of recovery," Thomas said. "When the economy seems to get better, bad loans are still on the books."

Like Thomas, **Dennis Nason**, a veteran international banker who heads a Coral Gables consulting and executive search firm, is optimistic about a second half turnaround - as bad banks and bad bankers are flushed from the system.

"We're going to get a wash through, and those that were poorly managed - where they didn't have good business plans, where they didn't have the depth of management - they're going to suffer from it," **Nason** said. "Some banks are going to prosper. You see banks bringing in capital, like BBU and Mercantil Commercebank, and they're going to go out and make good loans because they will make them at the new appraised values, not the old appraised values. So I think we're going to see a resurgence and rebuilding as we go into the second quarter."

Mehdi Ghomeshi, chief executive of Great Florida Bank in Coral Gables, notes that in areas like commodity prices, the interest rate environment, sales of existing homes and the stock market, the economy has improved tremendously.

"Banks are doing significant lending on home mortgages," Ghomeshi said. "The question is, when are they going to starting lending on non-home mortgages, like small business? As the economy improves, they'll start lending on that segment also."

Time of reckoning

The first half of the year will likely be a time of reckoning for several community banks.

Noting that Georgia and Florida together account for about a quarter of the nation's troubled banks, Thomas said that the satellite office the Federal Deposit Insurance Corp. opened this past fall in Jacksonville will be visible and active. Georgia has had 25 bank failures this year - the same number the entire nation had in 2008.

"They've been very aggressive from that Jacksonville office on Georgia. They're now focusing on the Gulf Coast of Florida; they're now just coming to the East Coast," Thomas said. "We'll see more bank failures here in the first part of the year - in the first quarter."

More bank failures, certainly, than the three that the region suffered in 2009. Thomas expects the number of failures nationwide to match the 140 that failed in 2009.

"The biggest concern for 2010 is going to be our economy down here in South Florida. What condition is it going to be in?" asked Cyril "Sid" Spiro, chief executive of Davie-based Regent Bank. "Any bank's performance is a function of the market within which it operates."

He also is preparing for a wave of regulatory reform.

"There are a lot of different proposals being bounced around. Between [Congress] and the administration and the regulatory agencies themselves, there seems to be wide divergence of opinion," Spiro said. "What are the practical effects going to be, particularly on community banks?"

For bankers, that means dealing with not just regulations, but regulators themselves.

"The examiners have been very tough," Thomas said. "They're asking for more reserves on loans, they're asking for more capital. No matter how much [banks] put in, they're going to be asking for more."

The No. 1 issue is adequate capitalization, **Nason** said. "It gives you the staying power that you're going to need to do a lot of other things."

Commercial real estate

Another challenge is what to do with mounting commercial real estate problems.

"Everybody's got problems," **Nason** said. "Some are just worse than others."

Ghomeshi said so far, commercial real estate has not been as bad as people expected, and he doesn't think it will be.

"As the economy recovers, commercial real estate will also," he said. "I just don't see how it could be nearly as bad as what we have experienced over the last 18 months with the housing side."

A key problem - one regulators are sure to focus on - is that so many South Florida banks are underreserved.

"We have several banks that are only reporting profits because they have underreserved," Thomas said. "That's a major issue because it's almost an artificial inflation of profits. Some of these banks report very small profits, and then you look at their reserves - they're only reserving 25 cents or less on the dollar of problem loans."

If those banks were properly reserved, they would not be showing a profit.

"The regulators know this, and they are really pursuing this," Thomas said. "We're going to see tougher enforcement, more enforcement actions both formal and informal."

But not every problem bank is going to find itself at the top of regulators' watch lists.

"There are some problem banks here that, on paper, look very bad but have sources of capital because they have deep-pocket parents," Thomas said. "As long as the parents in Venezuela or wherever are writing checks to strengthen the capital base, the regulators will be held at bay. It's only in those cases like [recently failed] Republic Federal, where there is no reasonable access for private capital, that they will close down."

BankUnited growth

While many banks are backed by wealthy shareholders, that doesn't mean they will be in any hurry to throw good money after bad, he warned.

"Regulators are looking for who can write the capital," Thomas said. "Private-equity money is something we may see more of, too. We've gone pretty much this entire year without BankUnited doing anything. There was a lot of speculation that they were going to make a move on another bank. I predict in 2010 we will see John Kanas making a move to expand the new BankUnited. They may go up the coast - they may pick up a bank. At some point, they are going to have to make a move."

Diversification will be another mantra bankers will hear from regulators.

"The banks will be under pressure to find solutions to getting money not only to Main Street but to individuals on Main Street," **Nason** said. "How can banks get their earnings up while they're backfilling on the real estate problems? They've got to keep their business flow going, which means you've got to go out and develop commercial loans and other businesses to keep your earnings flow while you've got all these loans on non-accrual."

Nason notes that the Federal Reserve is asking banks to have at least three lines of business.

"If you're tied down in commercial real estate you'd better find some commercial loans, or you'd better find some [Small Business Administration lending] or some other things," he said. "Banks need to loan, but they can't just loan. It takes 90 to 120 days to make a good loan. We're not a market in which we are very deep on good commercial companies for them to lend to," **Nason** said.

Georgia example

Another major issue is that within the state, the court system is not functioning.

"This is really seriously exacerbating the problems here in Florida," Spiro said. "It's taking now over a year to have an uncontested foreclosure. It can take up to three or four years if there is any type of contest. That's ludicrous."

Spiro noted that in Georgia, for example, an uncontested foreclosure is done in 45 days.

"This is not permitting all this property that's under foreclosure to be pushed through the system," he said. "I've heard estimates as high as 80,000 or 90,000 units backed up. The state's saying we don't have the money. They live off property tax to a large degree. I've never seen such a case of penny-wise and multi-pound foolish."

Steven Hayworth, chief executive of Coral Gables-based Gibraltar Private Bank & Trust, said he expects a bumpy environment for the next two years.

"Clearly, Florida is so closely tied to real estate," he said. "One of the things all banks are doing is trying to work with clients - a lot of good customers who are simply struggling through a difficult environment."

At the same time, banks have to take a tough approach with people who are trying to take advantage, and "you've got to know the difference."

Hayworth is also working to build client loyalty "that will withstand any environment," and says banks will absolutely need to be more proactive with their regulators.

"Regulators don't like negative surprises," he said. "I want to keep them very much apprised as to what's going on, specific to Gibraltar Private, and I also want to ask them what they are seeing. They've seen it all, so they can be extremely helpful to us."

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