

Loan Distress and Bank Failures: Recent History, Current Conditions and Near-term Outlook

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Introduction

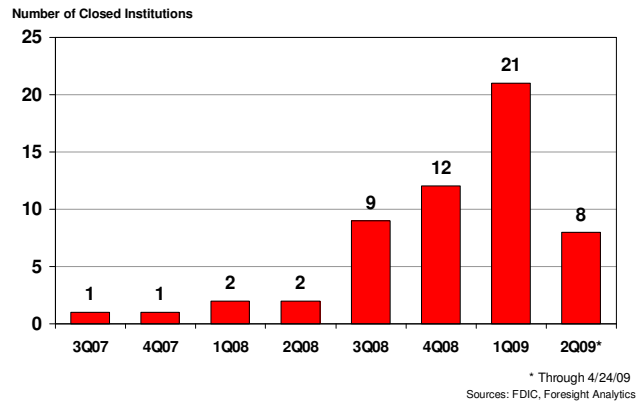
The current cycle of bank failures got underway in September 2007, with the closure of _____ in Alpharetta, GA. During this cycle, there have been 56 closures,¹ ranging in size from the \$19 million _____ to the \$307 billion _____. The current cycle entered a new phase in July 2008, with the failure of _____, as failures have grown larger and more frequent.

- As with past cycles, this cycle is primarily being driven by insolvencies — as bad loans mount, failing institutions' equity capital is depleted, leading to liabilities exceeding assets. With the downturn in the housing market, banks that were heavily exposed to residential mortgage and construction lending have experienced increasing defaults and mounting losses on nonperforming loans.
- Liquidity issues have emerged as well, also in keeping with past cycles, with deposit outflows driving or accelerating some of the closures. These bank runs are self-fulfilling to some extent — with large amounts of cash being drained from an institution, an otherwise solvent bank can quickly become insolvent. And for banks that are already facing solvency concerns, the liquidity issue becomes even more sensitive. As a result, bank regulators are very careful to guard against raising solvency or liquidity concerns about specific banks.
- This report is the first part of a two-part study on the outlook for bank failures. This first part provides our near-term projections for failures — through the third quarter of 2009 — based on our assessments of current distress in bank loan portfolios. The second part will analyze estimated asset values and resulting default and loss projections for major components of bank real estate lending.
- While the approach used in this report has been accurate, helping to identify 85% to 90% of the failures so far, it is based on information provided by the banks. In a handful of cases — including the two smallest failures so far — banks were closed that did not appear to have the level of distress that would warrant closure. In these cases, regulators obviously had more information on the banks' true condition. There is thus some level of information asymmetry and a risk that this approach will miss under-reported problems in bank loan portfolios.

¹ Through 4/24/2009.

² Tier 1 Capital — also called “core capital” — it includes common and preferred equity shares, minus goodwill and other intangible assets (such as a portion of mortgage servicing rights).

Bank Failures
Current Cycle



Recent Failures - Current Cycle

- Most failed banks in the current cycle have been relatively small, with median assets of \$336 million. _____ is by far the largest, at \$307 billion in assets, and is also the largest failed bank in U.S. history. _____, at \$32 billion in assets, is a distant second, but still much larger than most other failed banks in the current cycle. (See Appendix I for data on failed institutions in the current cycle.)
- The failed institutions have featured large volumes of nonperforming loans (or NPLs), especially relative to their capital bases. The median ratio of NPLs to Tier 1 Capital² was 281% for the banks that have failed, as compared with the U.S. median of 8% in 4Q 2008. Some of the failed banks have ranged much higher, such as _____ (2105%), _____ (1632%), _____ (1500%) and _____ (1431%).
- The primary sources of weakness have been from the residential housing sector, both from sharply higher default rates on single family mortgages and from soaring defaults on residential construction loans. By our estimates, more than 90% of the housing markets in the U.S. have experienced price declines as of 4Q 2008. The most severe declines have occurred in California, Florida and Nevada, each of which has markets that have fallen 40% or more from their peaks. Prices in some markets are off by 60% to 70% from their peaks.
- Commercial real estate problems have been less pronounced, but were a significant factor in a few failures, such as _____, _____, and _____. Commercial real estate loan defaults also played a role, albeit a smaller one, in the failures of _____, _____, _____, _____ and _____.

Appendix V - Summary Statistics (Current Watch List)

**Watch List Summary
Capitalization
As of 4Q 2008**

Capitalization Category*	As Reported	Pct of Total	Foresight Adjusted	Pct of Total
Under	22	8.0%	65	23.6%
Adequate	19	6.9%	61	22.1%
Well	235	85.1%	150	54.3%

* Tier 1 Risk-Based Capital. See Appendix II for definitions.

Source: Foresight Analytics

**Watch List Summary
Length on List
As of 4Q 2008**

Quarters on Watch List	Number	Pct of Total
1	152	55.1%
2	52	18.8%
3	36	13.0%
4	19	6.9%
5	11	4.0%
6+	6	2.2%

Source: Foresight Analytics

**Watch List Summary
Size - Total Assets
As of 4Q 2008**

Total Assets	Number	Pct of Total
< \$100 million	63	22.8%
\$100 to 250 million	91	33.0%
\$250 to 500 million	55	19.9%
\$0.5 to 1.0 billion	31	11.2%
\$1 to 5 billion	23	8.3%
> \$5 billion	13	4.7%

Source: Foresight Analytics

Watch List Totals by State
Number of Banks on Watch List, 1Q07 to 4Q08

State	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08*
Alabama			1	2	1		3	4
Alaska								
Arizona				1	1		1	8
Arkansas	1			1	1			1
California		1			8	12	9	14
Colorado			1	1	1		2	2
Connecticut								1
Delaware								
D.C.								
Florida	1	2	4	6	10	14	23	35
Georgia	3	3	3	9	18	28	32	49
Hawaii								
Idaho								
Illinois	2	2	3	3	8	10	15	32
Indiana								2
Iowa	1	1	1	1	1			5
Kansas			1		1	2	2	9
Kentucky	2	1	1	1				1
Louisiana						1	1	3
Maine					1	1		
Maryland	2	2	2	2	2	2	2	5
Massachusetts			1	1		3	3	2
Michigan	1	1	1	4	4	5	5	14
Minnesota				3	4	6	6	14
Mississippi								
Missouri	1	1	3	3	2	3	5	10
Montana								1
Nebraska				1			2	2
Nevada						3	4	5
New Hampshire								
New Jersey				1	2	2	2	4
New Mexico		1	1	1	1			2
New York	1						2	3
North Carolina								1
North Dakota				1	1			
Ohio	3	3	2	1	1	1	3	2
Oklahoma	1	1	1	1	1	1	1	4
Oregon			1				3	6
Pennsylvania	1			1	2	2		1
Rhode Island								1
South Carolina								1
South Dakota		1	1		1	1	1	2
Tennessee							2	
Texas					1	6	3	4
Utah				1	1	1	2	7
Vermont								
Virginia			1	2	1	2		2
Washington					1	1	2	9
West Virginia			1	1	1	1		
Wisconsin	1					1	2	3
Wyoming								1
Puerto Rico							3	4
Total	21	20	30	49	77	109	141	276

* Methodology expanded in 4Q08.

Source: Foresight Analytics

Appendix VI - Foresight Analytics Current Watch List

Note: Receipt of the Foresight Analytics Watch List requires the execution of a Confidentiality Agreement. Each recipient of our Watch List must complete an individual copy of the Agreement. The Watch List is available in a numbered hard copy version only, printed on security paper.

Any copying or duplication of this list is expressly prohibited.

The following sample table illustrates the contents of our Watch List.

