

Despite hints of change, real estate will still drag on banks

January 1, 2010

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Bank portfolios were hampered during all of last year by loans to homebuilders that became strained as the housing market dried up. By the middle of the year, homebuilder loans were joined on the troubled list by rising problems with commercial real estate (CRE) loans, a tsunami that hit the rest of the country hard earlier and seems to have made its way to the Middle Atlantic States. The combination of homebuilder and CRE loans came to a head in the third quarter when local banks saw significant increases in nonperforming assets as a percentage of total assets.

But bankers say the homebuilder market has begun to thaw as, aided by the first-time homebuyer tax credit program, homes have started to sell again. Portfolios in those areas should see some modest improvement in 2010, but bankers say CRE has not reached the bottom and should be a problem all year.

“I’ve seen some modest movement with residential sales but now commercial real estate is more of an issue and will be through 2010 and into 2011,” **Fox Chase Bancorp CEO Tom Petro** said. “The pace of formation of nonperforming loans will slow down but the pace of resolving them will be even slower.”

Kent Lufkin, CEO of TF Financial Corp., parent to 3rd Federal Bank in Newtown, said residential developments are seeing a little improvement and he gives some credit for that to the first-time homebuyer program.

“But the sales are largely affordable homes, not expensive ones,” Lufkin said. “The government said recently that the sales of existing homes increased but how many of them were foreclosures or taking the deed in lieu of a foreclosure and not a sale to a new owner?”

Jay Goldstein, CEO of Mount Airy startup Valley Green Bank, said he’s optimistic that residential real estate problems have bottomed out and opportunities will be available. But he thinks more problems with commercial real estate could offset that. Goldstein said those portfolios supported by national retailers or major office buildings will have some trouble.

“Larger commercial office space is more exposed,” Goldstein said. “If a law firm dissolves and leaves three quarters of the building vacant, it will be tough to collect rent

and cover debt service because there are few prospects to fill the space. Mixed use is much easier.”

Goldstein said clients struggling are those planning to flip residential real estate or buy commercial real estate for the purpose of renovating and renting because there is trouble finding renters.

“Anything that is speculative in nature is an issue,” Goldstein said.

Another problem banks will grapple with is regulatory pressure on loan losses and capital levels. Several local banks entered into public enforcement agreements with federal regulators during 2009. Bankers said regulators enhanced the pressure during the latter part of the year and there are no signs the pressure will let up in 2010.

Harleysville National Bancorp was forced to sell to Buffalo, N.Y.-based First Niagara Financial Corp. in August after coming to the conclusion that it would struggle to raise the amount of capital regulators required to be considered well capitalized.

This week, First Chester County Corp. said it would be sold to Tower Bancorp of Harrisburg for \$65 million after it decided that a sale was preferable to diluting stockholders by means of a capital raise. First Chester was also required to raise capital through a memorandum of understanding made public earlier this fall.

David Lazar, an investment banker with Stifel Nicolaus who deals with the financial services sector, said he and his colleagues have been inundated with requests from banks to assist with capital raises since August. He predicts capital will still be a focal point, whether because of troubled balance sheets, increased regulatory demands or banks’ wanting to take advantage of a merger or acquisition opportunity. While there was not a lot of merger or acquisition activity last year, Lazar believes that will change in 2010. He also said we could see the area’s first local bank failures of this recession.

“We won’t see any new banks, several will fail and several more will be acquired or merge,” Lazar predicted. “There certainly will be fewer banks [this time next year].”

Petro said there will be three types of banks this year. “Those with acceptable capital levels, those with no access to improve capital levels and those that fail,” Petro said. “The last two will try and consolidate into the first one.”