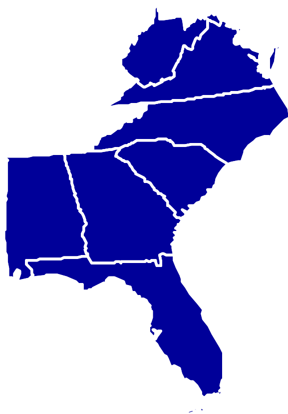
◈ Regional Outlook ◈

FEDERAL DEPOSIT INSURANCE CORPORATION — FIRST QUARTER 1997

In Focus This Quarter

FDIC ATLANTA REGION



■ ***Consumers Declare Bankruptcy in Record Numbers -*** **Despite favorable economic conditions, consumers are declaring bankruptcy in record numbers in the Atlanta Region. The increases in both personal bankruptcy filings and consumer credit losses are part of a national trend which has the attention of industry participants, regulators, and Congress.** *See page 3.*

■ ***New Tax Benefits for Owners of Community Banks -*** **The Small Business Job Protection Act of 1996 allows closely held banks, thrifts and holding companies to take advantage of various pass-through benefits of the subchapter "S" corporation tax structure. These benefits are potentially substantial and may increase the inherent value of community banks.** *See page 6.*

■ ***Savings Association Insurance Fund (SAIF) Capitalized -*** **After more than two years of hard work by regulators, Congress, and the banking and thrift industries, the Deposit Insurance Funds Act of 1996 was passed to address the serious problems of the SAIF.** *See page 9.*

DIVISION OF INSURANCE

JACK M.W. PHELPS, SENIOR REGIONAL ANALYST

Regular Features

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Dear Reader,

The prototype edition of the *Regional Outlook* for the Atlanta Region is attached. The *Regional Outlook* is produced by the Division of Insurance (DOI) and is designed to discuss events and trends affecting insured depository institutions in your region. This publication will be produced and distributed quarterly in our effort to share information and work with the Divisions of Supervision (DOS) and Compliance and Consumer Affairs (DCA) to identify emerging risks to insured depository institutions.

The publication contains two sections. The first section, *In Focus This Quarter*, contains several articles which are designed to address significant issues affecting insured depository institutions. The articles are not intended to represent an exhaustive coverage of the subject matter or to be examination guidance. The second section, *Regular Features*, will focus on the Regional Economy, Financial and Commodity Markets, and Banking. This section is not intended to be a substitute for your local or national newspaper but is intended to address some emerging trends and relate them to insured depository institutions.

This publication is regional in focus with individual states and metropolitan areas highlighted where possible. We recognize the importance of local economic information to examiners and intend to address that particular need more thoroughly in another product. DOI will provide periodic economic analyses at the Field Office level in the future.

This publication may be distributed on a wider basis in the future, but it was designed largely with an examiner audience in mind. DOI is very appreciative of the time and constructive feedback members of DOS's and DCA's Chicago staffs provided in the design and testing of the *Regional Outlook.* Many of the suggestions received from those individuals were incorporated into this publication. Your comments on the publication's format and contents, including suggestions for future articles, are welcomed. We also would appreciate your thoughts about the desirability of providing this publication by way of our intra-net homepage, or some other electronic format.

Sincerely,

Arthur J. Murton
Director

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The views expressed in the ***Regional Outlook*** are those of the authors and do not necessarily reflect official positions of the Federal Deposit Insurance Corporation. Some of the information used in the preparation of this publication was obtained from publicly available sources and is considered reliable. However, its use does not constitute an endorsement of its accuracy by the Federal Deposit Insurance Corporation.

Ricki Helfer, Chairman, Federal Deposit Insurance Corporation

Arthur J. Murton, Director, Division of Insurance

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Design and Production	Steven E. Cunningham, Senior Financial Analyst Diane Ellis, Senior Financial Analyst

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Consumers Declare Bankruptcy in Record Numbers

Trend Raises Concerns about Consumer Credit

- **Despite favorable economic conditions, personal bankruptcy rates are rising throughout the Atlanta Region.**
- **Georgia, Alabama, and Virginia stand out among states in the Atlanta Region with the second, third, and seventh highest per capita bankruptcy rates in the country, respectively.**
- **Credit card charge-offs are approaching recession levels.**

Despite favorable economic conditions, consumers are declaring bankruptcy in record numbers in the Atlanta Region. The increases in both personal bankruptcy filings and consumer credit losses are part of a national trend which has the attention of industry participants, regulators, and Congress. Both the Senate and House Banking Committees have held hearings on the condition of consumer credit, particularly credit card lending. Much of the concern regarding these trends is due to the fact that bankruptcy filings and charge-offs are rising despite low unemployment and rising income levels.

What Is Occurring in the Atlanta Region?

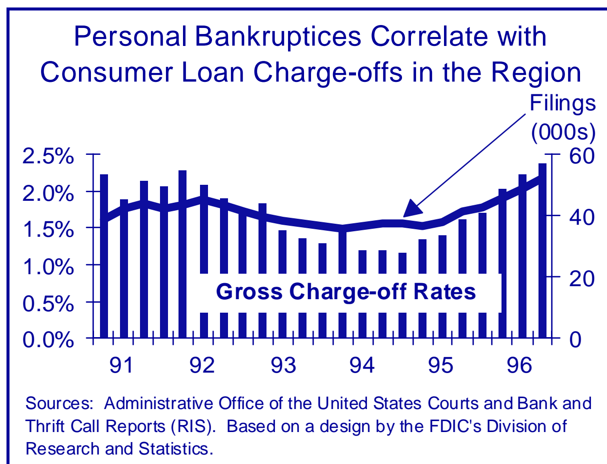
Chart 1 shows the rising trend in consumer loan losses in the Atlanta Region as well as the relationship between charge-offs and personal bankruptcy filings. Table 1 shows that personal bankruptcy rates are rising in all states throughout the Region. Within the Atlanta Region, three states are ranked particularly high on a nationwide basis. Georgia is ranked number two, Alabama is ranked number three, and Virginia is ranked number seven in the number of bankruptcies filed.

Why Are Consumer Credit Losses Rising in an Expanding Economy?

The emergence of consumer credit problems during an expanding economy is not unprecedented. During the last economic expansion, consumer delinquency and charge-off rates also rose. Consumer debt tends to rise when employment rises because households are more willing to incur debt and banks are more willing to lend. Chart 2 shows that past cycles of rising growth in consumer credit have been followed by rising delinquency rates, even during periods of expansion.

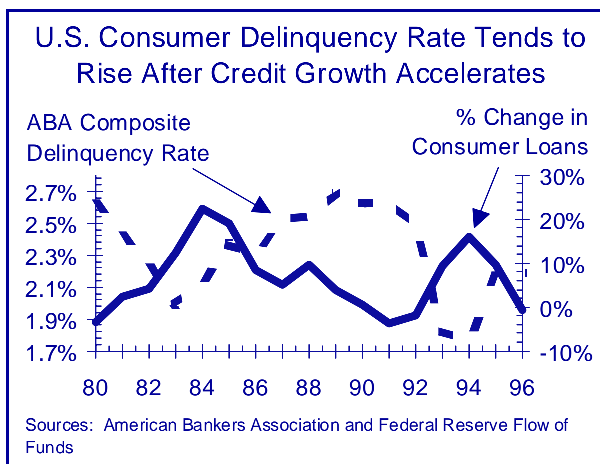
As the expansion closes out its sixth year, American consumers are holding historically high levels of consumer debt -- the ratio of total consumer debt service payments, including mortgage, to disposable personal income is approaching record highs and is currently at 17 percent. High debt levels appear to be the result of several years of economic expansion along with credit card companies' intensive efforts to generate and feed consumers' appetite for credit. Consumers and their lenders are now experiencing the after-effects of this credit expansion.

Chart 1



Sources: Administrative Office of the United States Courts and Bank and Thrift Call Reports (RIS). Based on a design by the FDIC's Division of Research and Statistics.

Chart 2



Sources: American Bankers Association and Federal Reserve Flow of Funds

Prototype

Why Are Bankruptcy Rates Rising?

Nonbusiness bankruptcy filings for 1996 will exceed one million for the first time in U.S. history. This level is 11 percent higher than the peak in the last recession and a 14 percent increase over 1995 filings. A variety of theories have been advanced to explain this trend. These theories include:

- Consumers have overextended themselves.
- Recent changes in bankruptcy laws make it easier to shield assets from creditors.
- Changes in legal practices promote bankruptcy.
- The social and financial repercussions associated with bankruptcy have diminished.

In fact, the trend is likely the result of several factors, many of which are interrelated.

A recent study by ***SMR Research Corporation*** attributes differences in filing rates more to state regulations than to economic conditions. The study found that bankruptcy is driven by the number of and exposure to catastrophic events. For example, divorce is often a financial calamity leading people to bankruptcy court and is associated with high personal filing rates throughout the country. The report identifies other factors driving up bankruptcy rates such as:
- inadequate health insurance;
- inadequate auto insurance;
- a large percentage of self-employed workers;
- garnishment of wages; and,
- high debt-to-income ratios.

All of these conditions increase consumers' exposure to catastrophic events, such as job loss, that are typically associated with personal bankruptcy.

Of interest to lenders is that some traditional early warning signs of trouble -- such as erratic missed payments or paying off a smaller share of outstanding balances -- are not evident this time. *Some banks are finding that obligations due to them are being wiped out in bankruptcy court on accounts that showed no prior problems.*

Implications for Insured Institutions

These trends have raised concerns about the outlook for credit card lenders. As shown in Chart 3 (next page), credit card charge-offs are approaching levels not seen since the aftermath of the 1990-1991 recession. During that recession, charge-off rates increased sharply. The question arises whether there would be a similar sharp increase in credit card losses during a future recession, driving credit card loss rates to levels well above their previous peak.

This concern is heightened by a number of factors. Consumer debt burdens are at historic highs. Profit margins for the nation's specialty credit card lenders (institutions whose total loans exceed 50 percent of managed assets and whose credit card loans exceed 50 percent of total loans) have rapidly narrowed from a

Table 1

Bankruptcy Rates Per Thousand Persons

	1990	1991	1992	1993	1994	1995	3rd Qtr 1996 Annual.	3rd Q 96 State Ranking
Alabama	6.55	6.65	6.18	5.56	5.41	6.10	7.11	3
Florida	2.97	3.55	3.63	2.92	2.88	3.10	3.87	25
Georgia	7.12	7.06	6.42	5.64	5.59	6.16	7.15	2
North Carolina	2.09	2.31	2.02	1.74	1.78	2.11	2.83	40
South Carolina	1.71	1.91	1.97	1.74	1.73	1.94	2.48	43
Virginia	3.25	3.95	4.15	3.63	3.44	4.08	5.07	7
West Virginia	1.83	2.12	2.24	1.82	1.84	2.13	2.95	36
United States	3.12	3.46	3.52	3.15	3.00	3.33	4.15	NA

Source: Bankruptcies - Administrative Office of the United States Courts
Population - Census Bureau

Prototype

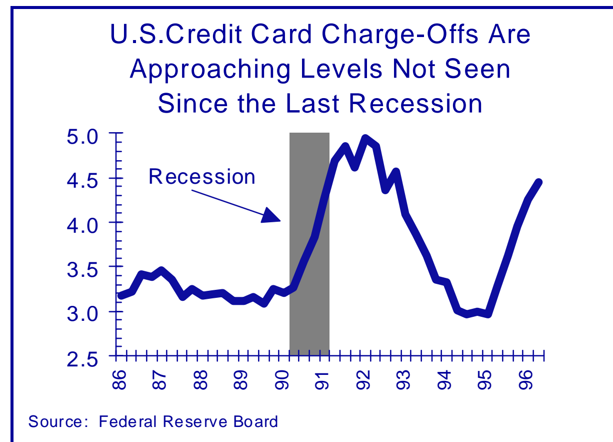
4.25 percent quarterly return on assets (ROA) in the third quarter of 1994 to a 2.02 percent quarterly ROA in the third quarter of this year. Competitive pressures on pricing and underwriting remain intense, as some companies continue aggressive card solicitations, and there are few signs of any slackening of price competition. A sharp rate cut for AT&T credit cards, one of the largest credit card lenders, is a recent salvo in this price competition. *Lenders also place great reliance on credit scoring models that have not yet been tested in a recession* and, according to a recent Federal Reserve survey, appear overly optimistic in almost two-thirds of the banks surveyed.

Other factors mitigate these concerns to some extent. Pricing of credit card loans has traditionally built in a margin of comfort for high and volatile losses. Loan portfolios are diversified with many small loans to individuals. There are preliminary indications that lenders and borrowers are retrenching to some extent. Consumer credit growth slowed from over 14 percent in both 1994 and 1995 to an annualized rate of 8 percent (seasonally adjusted) for the first ten months of 1996. In the Federal Reserve survey just mentioned two-thirds of banks reported raising the score an applicant must achieve to qualify for credit, and one-third reduced credit limits for existing customers.

Generalizations about the outlook for credit card lending are difficult. Trends that describe the industry on average may not hold true for particular institutions.

Performance is likely to vary substantially, with results depending on the risk management practices and underwriting standards of each institution. Given the trends outlined above, credit card lending practices appear worthy of continued close attention by bankers and regulatory agencies.

Chart 3



Diane Ellis, Senior Financial Analyst
Jack M. W. Phelps, Senior Regional Analyst

New Tax Benefits for Owners of Community Banks

Subchapter "S" Benefits Now Available

- **Potential benefits are substantial. A layer of tax expense has been eliminated.**
- **Eligibility is restricted and requires care to maintain.**
- **While no application to the banking agencies is required, the new tax structure has supervisory implications.**
- **The new tax structure has some potential drawbacks.**

Introduction

The Small Business Job Protection Act of 1996 allows closely held banks, thrifts and holding companies to take advantage of various pass-through benefits of the subchapter "S" corporation tax structure. These benefits are potentially substantial and may increase the inherent value of community banks.

Eligibility Is Restricted

The new law allows, for the first time, financial institutions including banks, thrifts, and holding companies to elect subchapter "S" status if they meet several criteria. *The most important of these requirements are that the company not use the reserve method of accounting for bad debts for tax purposes and that it have 75 or fewer eligible shareholders.* All shareholders must consent to the subchapter "S" election and the IRS must consent to any change in the tax accounting for bad debts. To be able to receive the benefits for tax year 1997, institutions need to meet all the requirements by year-end 1996.

Industry observers have suggested that over 1,000 banks nationwide will make the subchapter "S" election.

Reserve accounting for bad debts for tax purposes is an issue affecting only smaller institutions. Currently, reserve accounting is allowed only for those thrifts and banks under $500 million in assets that are not part of a group with more than $500 million in assets. To elect the new tax status, the subchapter "S" company will need to make the accounting change to the specific charge-off method for tax purposes. Presumably, the IRS will not object to any such change, which can delay deductions and increase taxable income, and will allow the change to be effective as of the beginning of the tax year.

In relation to shareholder eligibility, ownership of subchapter "S" corporations is limited to individuals, estates, and a few types of trusts. At present, certain shareholders, such as corporations, Employee Stock

Table 1

Number of Banks with Under $100 Million in Total Assets	National	Non-Member	State Member	Total
Alabama	21	87	17	125
Florida	40	95	30	165
Georgia	28	206	3	237
North Carolina	2	15	0	17
South Carolina	13	34	3	50
Virginia	9	15	40	64
West Virginia	20	35	13	68
Total	133	487	106	726

Source: Preliminary Bank Call Reports as of 9-30-96

Prototype

Ownership Plans (ESOPs) and other stock bonus plans, may not hold shares in subchapter "S" corporations. Once the subchapter "S" election is taken, the corporation and its shareholders must take care to continue to meet all eligibility requirements or risk losing the tax benefits.

Number of Eligible Institutions

While exact figures on the number of eligible institutions are not available, the number of small banks may provide insight into where the tax election may be seen. As Table 1 (previous page) shows, there are about 726 commercial banks in FDIC's Atlanta Region with under $100 million in assets. Table 2 shows there are about 354 commercial banks with under $50 million in assets. It is expected that a large percentage of these companies would meet the eligibility requirements. Some industry observers have suggested that over 1,000 banks nationwide will make the Subchapter "S" election.

Benefits to Shareholders

The tax benefits of the "S" corporation are similar to those of a partnership. The earnings of the corporation generally are not taxed at the corporate level but pass directly to shareholders' personal income. *As such, cash distributions to shareholders are not subject to an additional layer of taxation, which results in a reduction in overall taxes.* Shareholders remain liable for personal taxes on their proportionate share of the corporation's taxable income. Distributions formerly paid directly to the IRS by the institution generally would be made to the shareholders, providing them with the funds to pay income taxes on their share of the corporate income. An interagency letter, FIL-91-96 dated October 29, 1996, notes that these distributions will be treated as dividends by the regulatory agencies.

Adding value and flexibility to the "S" corporation structure is the ability to wholly own other "S" corporations. These rules allow holding companies and their bank or savings association subsidiaries to be "S" corporations.

Other Tax Liabilities

For bank or thrift companies that elect to convert to "S" corporation status, there are potentially some other corporate tax liabilities for unrealized gains accumulated through the date of conversion. As an example, should the fair market value of all company assets exceed the adjusted tax bases of these assets, there may be some corporate tax liability if any assets are later sold. Assets held on conversion date and sold within the next ten years require a calculation for "Built-in Gains Tax" (BIG tax) to determine any tax at the corporate level.

Supervisory Implications

While an application to bank regulators is not required for this tax election, there may be a rise in various "phantom bank mergers" or change-in-control applications as companies work to meet shareholder number requirements or attempt to get the required 100 percent shareholder approval.

Table 2

Number of Banks with Under $50 Million in Total Assets

	National	Non-Member	State Member	Total
Alabama	10	50	10	70
Florida	15	47	13	75
Georgia	10	107	2	119
North Carolina	1	7	0	8
South Carolina	6	19	2	27
Virginia	5	8	13	26
West Virginia	5	20	4	29
Total	52	258	44	354

Source: Preliminary Bank Call Reports as of 9-30-96

Prototype

Shareholders may enter agreements that place limits on their ability to sell their stock. In addition, the mechanics of a conversion will require some special expertise for the bank in tax law and accounting. The change from the reserve method to the specific charge-off method for bad debts or the existence of net operating losses may present unique circumstances for each institution.

Bank portfolios also may undergo changes prompted by shareholders' requests. An example might be increased purchases of tax-free securities to meet the desires of shareholders for more tax-free interest. Another may arise from a tendency to remove accumulated earnings to pay personal taxes as the corporation generates earnings. This could place a strain on capital in situations where growth is strong or delinquent assets are rising.

Other Drawbacks

To receive the benefits of the subchapter "S" election, the institution will need to meet all the eligibility requirements for every day of the tax year. Furthermore, the IRS has not yet resolved all the tax issues related to the subchapter "S" election on the part of financial institutions. Specific guidelines from the IRS are expected by year-end 1996 which may affect an institution's decision to elect subchapter "S" status.

The states of Connecticut, Michigan, New Hampshire, New Jersey, Tennessee as well as the District of Columbia do not recognize the federal subchapter "S" election. Therefore, these jurisdictions do not allow the pass-through benefits of the "S" corporation for the applicable state or district taxes.

Subchapter "S" institutions remain under the same capital adequacy standards and dividend restrictions as other institutions. However, there are times when it may be difficult to maintain the subchapter "S" status. An example would arise when an institution needs to raise capital to meet Prompt Corrective Action (PCA) guidelines. *To meet the IRS requirements for subchapter "S" election while raising the necessary capital, current shareholders may have to be the primary source of new capital.* The ability to raise additional capital by attracting new eligible shareholders may be difficult because the total number of eligible shareholders must remain 75 or fewer to preserve the "S" status. Furthermore, no new classes of stock may be issued. Violation of any of these criteria would result in the loss of the subchapter "S" status and reversion to regular corporate tax rules.

Distributions to shareholders are covered by similar restrictions for subchapter "S" corporations as for regular corporations. However, one possible new twist is that, in some cases, the tax liability payment for shareholders may be due before distributions are funded from the institution. However, this is considered similar to pressures brought by shareholders in other corporations when they require dividend payments to fund debt payments on stock loans.

There may be a rise in various "phantom bank mergers" or change in control applications as the companies work to meet shareholder number requirements or attempt to get the required 100 percent shareholder approval.

New Value for the Community Bank Charter

Overall, this newly legislated tax break for closely-held financial institutions may invigorate the value of the community bank or thrift. However, it also adds a new "wrinkle" in the complexity of the examiner's job. While consolidation trends can be expected to continue at larger companies, the new tax benefits available for closely-held institutions add a new incentive for the survival of community banks and thrifts.

Ronald L. Spieker, Chief,
*Depository Institutions Analysis Section **

For More Information

Subchapter S Election for Federal Income Taxes. FIL-91-96.

* Extensive review and comments were provided by Robert F. Storch, Chief, Accounting Section of the Division of Supervision.

PROTOTYPE

Savings Association Insurance Fund (SAIF) Capitalized

FDIC Lowers Assessment Rates

- **SAIF was capitalized through a $4.5 billion special assessment. Almost 400 banks and thrifts in the Atlanta Region paid $650 million of this total.**
- **Bank Insurance Fund (BIF) members will bear part of the cost of the Financing Corporation (FICO) bonds beginning in 1997.**
- **The special assessment negatively affects 1996 operating performance, but earnings prospects are greatly enhanced by a proposal to lower future SAIF assessment rates.**

Why Was Action Needed?

After more than two years of hard work by regulators, Congress, and the banking and thrift industries, the Deposit Insurance Funds Act of 1996 (Act) was passed to address the serious problems of the SAIF.

The difficulties facing the SAIF were substantial and demanded a solution. They primarily fell into the following areas:

- SAIF was undercapitalized and there was concern that one large, or several sizable, thrift failures could quickly deplete the fund balance. Its balance was $3.9 billion, or 0.55 percent of insured deposits, on June 30, 1996, well below the target reserve ratio of 1.25 percent of insured deposits.
- Over 45 percent of SAIF assessments were being diverted from the SAIF to pay off FICO obligations arising from the thrift failures of the 1980s.
- The SAIF assessment base continued to shrink, with a 22 percent reduction noted from year-end 1989 to June of 1996.

About 85 percent of the Atlanta Region's institutions paying the special assessment posted a quarterly net operating loss for the third quarter of 1996 ...

- Disparity between SAIF and BIF premiums created strong economic incentives for institutions to transfer SAIF-assessable deposits to affiliated institutions insured by the BIF, contributing to the shrinkage in the SAIF assessment base.

What Significant Actions Were Taken?

Table 1

Atlanta Region Institutions Affected by SAIF Special Assessment

Number of Institutions Affected and Total Assessment by Type	Mutual	Savings Banks	S&L	State Member	National	Non-member	Total
Alabama	0	11	6	5	2	11	35
Florida	0	49	12	9	14	14	98
Georgia	0	23	11	6	13	14	67
North Carolina	39	6	16	1	3	11	76
South Carolina	0	12	20	0	5	4	41
Virginia	1	23	6	14	6	2	52
West Virginia	0	7	2	0	6	3	18
Total	40	131	73	35	49	59	387
Assessment ($000s)	20,805	183,097	59,332	63,275	246,114	76,854	650,287

Source: Derived from early estimates of the FDIC's Division of Finance

Prototype

Special Assessment: In order to address the immediate problems, *the Act required the FDIC Board of Directors to impose a special assessment of approximately 65.7 basis points on SAIF-member institutions.* The special assessment was designed to increase the fund's level to 1.25 percent of insured deposits effective October 1, 1996. In determining the amount, the Board:

- Exempted weak and other specifically defined institutions from paying the special assessment.

- Decreased by 20 percent the amount of SAIF-assessable deposits against which the special assessment will be applied for certain Oakar and other institutions. (An Oakar institution is a member of one insurance fund that has acquired deposits insured by the other fund. The acquired deposits retain coverage under the seller's fund.)

Early estimates are that there will be fewer than ten exempted institutions in the Atlanta Region. This number of exempted institutions is small compared with the estimated 387 institutions in the Region that paid about $650 million to the SAIF in November. As Table 1 (previous page) indicates, the special assessment affects more than just thrifts. This is due to the substantial number of banks that have acquired SAIF deposits through acquisitions or branch purchases over the last few years.

Table 2

Summary of 1997 Assessment Rates *			
1997 Adjusted BIF & SAIF Schedule			
Capital Group	Supervisory Subgroup A	B	C
1	0	3	17
2	3	10	24
3	10	24	27
Exempt Institution SAIF Schedule			
1	23	26	29
2	26	29	30
3	29	30	31
FICO Annual Rates			
BIF Institutions		SAIF Institutions	
1.30		6.48	

* Cents per $100 of domestic deposits

Source: FDIC's Division of Insurance

FICO Costs: The recently enacted legislation also addressed another legacy of the problems thrifts experienced in the 1980s -- FICO bonds issued in 1987 to help shore up the former Federal Savings and Loan Insurance Corporation (FSLIC). The cost of financing this debt, about $800 million per year, was a major reason the SAIF had not improved as quickly as the BIF.

The Act authorized FICO to impose periodic assessments on BIF members in addition to members of SAIF that were already being assessed. The FICO charge on BIF-assessable deposits must be one-fifth the charge on SAIF assessable deposits. As a result, *the FICO charge on SAIF-assessable deposits for the first semi-annual assessment period of 1997 will be 6.48 basis points (annualized), and the charge on BIF-assessable deposits will be 1.30 basis points (s*ee Table 2). As necessary, FICO rates will be adjusted on a quarterly basis to reflect changes in the assessable-deposit bases for the BIF and the SAIF. Beginning on January 1, 2000, or, when the insurance funds merge, whichever occurs earlier, BIF and SAIF members will share the FICO assessment on a pro rata basis. (FICO assessments will be paid in addition to the deposit insurance assessments. See discussion below.)

Final Rule to Lower SAIF Assessment Rates: With the SAIF now capitalized by the special assessment, the FDIC Board of Directors lowered the rates on ongoing assessments paid to the SAIF. The Board also widened the spread between the lowest and highest rates to improve the effectiveness of the FDIC's risk-based premium system.

The final rule establishes an adjusted SAIF rate schedule of 0 to 27 basis points effective for all non-exempt institutions beginning January 1, 1997. (Since only SAIF-member savings associations must, by law, pay for FICO assessments until the end of 1996, a special interim rate was established for SAIF-member savings associations for the last quarter of 1996.)

As is noted in Table 2, institutions exempted from paying the special assessment will not benefit initially from the lower SAIF assessment rates. They will pay according to the 23- to 31-basis point schedule through year-end 1999, unless they choose to make a pro rata payment of the special assessment in the interim.

Prototype

Implications for Insured Institutions

Institutions that are required to pay the SAIF special assessment should have accrued a liability and an offsetting noninterest expense as of September 30, 1996. As a result, many such institutions will reflect much lower operating earnings this year. In fact, over 85 percent of the Atlanta Region's institutions paying the special assessment posted a quarterly net operating loss for the third quarter of 1996 primarily due to the special assessment.

Concerns over the short-term financial impact described above are moderated by much brighter future prospects. First, the special assessment is a one-time charge and should not affect future earnings streams of nonexempt institutions. Second, the proposed lower SAIF assessment rates should actually help to boost net income in 1997. Finally, some observers have noted that the resolution of the SAIF's deficiencies should remove uncertainties that may have depressed stock prices of SAIF-member institutions. Over the longer-term, the capitalization of the SAIF and the change in assessment rates also pave the way for a dialogue about a possible merger of the two deposit insurance funds.

John D. Weier, Chicago Senior Regional Analyst

For More Information

- SAIF Assessments. FIL-88-96
- Accounting for the SAIF Special Assessment and FICO Assessments. FIL-90-96
- Federal Register 61, No. 201, pp. 53834-53841: Assessments.
- Federal Register 61, No. 201, pp. 53867-53876: Proposed Rules - Assessments.
- Press Release 79-1996 and 63-1996.
- Chairman Helfer's Speeches: July 19, 1996, and October 28, 1996.

Atlanta Region -- A Diverse and Growing Economy

- **State economies in the Region are very diverse -- from West Virginia's coal mines and blast furnaces, to Florida's draw as a tourism and retirement area. According to at least one forecast, the Region generally should outperform the nation in 1997.**

- **Health care is a dominant part of the landscape in most states in the Region and may pose a risk to some economies if ongoing consolidation in the industry adversely affects employment.**

- **A mix of cyclical industries, such as textiles and chemicals manufacturing, and less-cyclical ones, such as health care and food and beverage manufacturing, should cushion the Region to some extent against a national slowdown.**

- **Real estate markets have been booming and providing significant job and income growth. Housing markets may decline modestly in 1997, in keeping with national trends, while commercial markets should con-**

Diversity Provides Stability

The seven states within the Region have very diverse fortunes, from Florida -- with a third of the Region's population and income -- to West Virginia, with four percent of the Atlanta Region's population and just three percent of its income. Table 1 ranks the states based on their relative importance to the regional economy. Data are for 1995, except for South Carolina (1994).

The Atlanta Region continues to draw companies in growing industries, particularly business services (e.g., accounting, personnel-supply, data processing), given its favorable climate and low cost of doing business. As indicated in Table 2 below, the Region also maintains a significant manufacturing base centered in the Carolinas.
Population growth has remained steady and continues to contribute to job and wealth creation for most states in the Region. Despite the inflow of new residents, unemployment rates generally have remained low.

For the Region as a whole, nonfarm employment growth slowed somewhat during the first ten months of 1996 but held on to a respectable 2.5 percent gain over the same period in 1995. For the first ten months of 1996, Florida's job base grew 3 percent after a 3.6 percent advance in 1995 and gains of 4 percent in both 1993 and 1994. Across the Region, job growth was strongest in Georgia, at nearly 4 percent, and weakest in Alabama, at just under 1 percent. As in the nation, *service-sector jobs have been providing most of the new employment opportunities in the Region during the 1990s.*

Many private-sector estimates call for continued modest growth in the U.S. economy during 1997. Forecasts by

Table 1

Atlanta Region is Dominated by Florida

	Share of Population (Percent)	Share of Income (Percent)
Florida	31.5	33.6
Georgia	16.0	16.1
North Carolina	16.0	15.7
Virginia	14.7	16.0
Alabama	9.5	8.3
South Carolina	8.2	7.0
West Virginia	4.1	3.3

Source: U.S. Census Bureau

Table 2

Carolinas Lead in Manufacturing, Florida & Virginia in Services

	Percent of 1995 Income	
	Manufacturing	Services
Florida	9.4	33.2
Georgia	17.4	25.1
North Carolina	25.5	21.2
Virginia	14.0	28.2
Alabama	22.8	22.5
South Carolina	34.9	26.4
West Virginia	16.4	24.0

Source: U.S. Census Bureau

Prototype

Table 3

Florida and Georgia Economies Slow but Still Outpace the Nation				
	Forecasted Growth over Prior Year, Percent			
	Gross Product		Nonfarm Employment	
	1996	1997	1996	1997
Florida	3.5	3.2	2.9	2.7
Virginia	2.2	2.9	1.6	2.1
Georgia	4.3	2.8	3.5	1.7
South Carolina	2.0	2.8	2.0	2.2
West Virginia	2.5	2.7	1.5	0.9
North Carolina	2.3	2.5	1.6	1.6
U.S.	2.3	2.5	2.0	1.5
Alabama	1.2	2.2	0.7	1.1

Source: Regional Financial Associates

Regional Financial Associates (RFA) look for an increase in Gross Domestic Product of 2.5 percent, accompanied by a gain of 1.5 percent in nonfarm jobs. Table 3 presents RFA's estimates for 1996 and 1997 forecasts for the Region's states. Although both Florida and Georgia (half the Region's economy) may see a slowdown in growth during 1997, they should still exceed the nation in gross (state) product and job gains. Only Alabama is expected to underperform the nation in gross product, while Alabama and West Virginia seem the most likely to underperform in terms of job formation.

Implications: *A diverse economy should cushion the Region somewhat in the event of a national slowdown.* Although the Region is home to many cyclical and commodity industries (e.g., agriculture, chemicals, paper products, and textiles), more stable industries, such as business services, health care, and consumer-noncyclical manufacturing, also are widely represented. This diversity will help to stabilize credit quality to the extent that the Region's lending institutions have commercial and industrial loan portfolios that are similarly well-diversified across cyclical and less-cyclical businesses. A diverse employment base will provide more stability in consumer credit quality as well.

Health Care Is a Significant Wealth Creator

Health care and business services have dominated recent growth in jobs and income. In all but one of the Region's seven states, health care (e.g., doctors offices and clinics, hospitals, nursing homes, etc.) accounted for at least one-third of state income derived from services in 1995. Table 4 provides state rankings of health care's share of income (data for South Carolina are for 1994).

Implications: With the share of state income from health care services rivaling income from other sectors, *the potential exists for this industry to negatively affect the regional economy if ongoing consolidation results in large job losses.* Lending institutions' consumer credit portfolios may deteriorate in direct proportion to the extent of their exposure to laid-off health care workers. Also, consolidation will put downward pressure on doctors and professionals' incomes, which might impact their ability to repay outstanding debts. Smaller health care companies, meanwhile, could be driven out of business by larger rivals, directly impacting their ability to repay outstanding bank loans.

Strength in Real Estate

Housing Market Hitting New Highs (Except in the Virginias): For the most part, housing markets across the Region are doing very well. Strong growth was seen in most areas through the second quarter of 1996, although some declines occurred in the third quarter. Sales of existing homes in Florida rose 5.5 percent between the fourth quarter of 1995 and the third quarter of 1996, to a seasonally-adjusted annual level of 240,000. In North Carolina, the Region's second

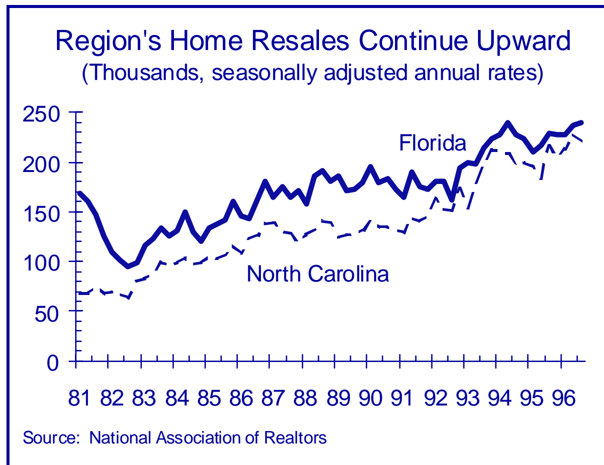
Table 4

Health Care's Importance to the Region		
	Percent of State Income	Percent of Services Income
Florida	11.4	34.3
South Carolina	11.4	43.0
West Virginia	11.2	46.7
Alabama	8.6	38.2
Georgia	7.9	31.5
North Carolina	7.6	35.8
Virginia	7.1	25.2

Source: U.S. Census Bureau

Prototype

Chart 1



largest housing market, sales reached a seasonally-adjusted annual level of 221,000 in the third quarter, up almost 8 percent from the end of 1995 (see Chart 1).

In many of the Region's metro areas, such as Birmingham and Mobile (AL), Jacksonville (FL), Richmond (VA), Greenville and Charlotte (NC), and Charleston (WV), median resale prices have risen by double digits in 1996.

Implications: The National Association of Realtors expects U.S. existing home sales to slip to 3.8 million in 1997 from their record pace of 4.1 million achieved in 1996. Except for some of the hottest markets in the Carolinas and Florida, home sales may also cool slightly in the Region during 1997 -- although they will remain at relatively high levels.

According to the *FDIC Real Estate Report*, the Atlanta Region has the highest proportion of assets invested in single-family mortgages. For example, Florida and West Virginia institutions have one quarter of their total assets in single-family mortgages. *A cooling in home-sales growth would be expected to adversely affect revenues from mortgage originations.*

Commercial Markets Strong: *Commercial real estate development has had a significant impact on the Atlanta Region's economic performance in recent years.* A strong inflow of service businesses, not to mention the recent Olympic Games, increased demand for office and industrial properties. For most states in the Region, construction accounts for about 6 to 7 percent of labor income, versus a 5 percent average for the nation.

In 1995, the value of new commercial building permits rose in every state except West Virginia. Planned commercial building activity remains robust in most markets, particularly those in Florida and in the Re-

Table 5

While Improved, Some Markets' Vacancy Rates Still Exceed National Average

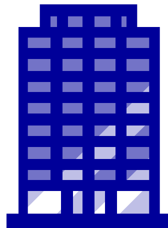
	Percentage of Available Space Unoccupied During Third Quarter 1996			
	Industrial	Office	Downtown Office	Suburban Office
U.S. Average	7.7	12.8	14.4	11.7
Florida				
Miami	7.6	15.0	20.6	11.7
Tampa	9.7	13.1	20.7	10.7
Palm Beach	1.7	12.1	N/A	12.1
Jacksonville	3.5	10.8	13.5	8.0
Orlando	8.9	9.5	7.0	10.5
Ft. Lauderdale	6.5	9.2	5.3	10.2
Georgia				
Atlanta	12.4	9.5	15.1	8.0
North Carolina				
Charlotte	6.3	7.5	5.7	8.9

Note: Data are average for the period.
Source: CB Commercial

Prototype

gion's major metro areas, like Atlanta. The market around Atlanta already has begun to experience a post-Olympic slowdown, but continued in-migration of service-sector firms should help to mitigate any decline in demand for the area's commercial and office real estate in 1997. Table 5 (previous page) provides recent vacancy rate information for some of the Region's larger metropolitan markets.

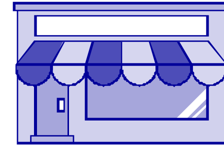
Office: Vacancy rates continued to fall and in many metro areas achieved ten-year lows in 1996. Much improvement has occurred in Atlanta and in some long-troubled Florida markets (which saw vacancy rates well above 20 percent in the early 1990s). However, massive overbuilding in markets like Miami and Tampa have led to persistently high vacancy rates.



Florida's many metro areas continue to have significant new office space in the planning stages. According to the FDIC's Division of Research and Statistics, the largest additions would occur in Fort Lauderdale and West Palm Beach (over 2 million square feet each, or 11 to 12 percent of existing inventory), Tampa (2.6 million square feet, or 10 percent of current inventory), and Jacksonville (almost 4 million square feet -- a 30 percent increase in existing inventory). Miami and Orlando have more conservative additions planned -- totaling about 1.5 million square feet each. These plans would add another 5 percent to Miami's inventory of office space, while increasing inventories in Orlando by roughly 8 percent.

Atlanta had some of the largest planned additions to office space as of last August -- over 7 million square feet, or 8 percent of total inventory as of mid-1996. Charlotte and Raleigh (NC) also were expecting 2 to 3 million more square feet of new office space sometime in the future. For Charlotte (data were not available for Raleigh), these additions would increase supply by about 12 percent.

Retail: With higher levels of retail employment, new additions to space appeared in 1996. Vacancy rates were mostly below 10 percent in many of the Region's metro areas -- matching or beating the 7 percent national average in Birmingham, Atlanta, Charlotte, Miami, and Raleigh-Durham. However, vacancy rates in Norfolk (VA), Greenville-Spartanburg (SC), Jacksonville, and West Palm Beach were all approximately 11 percent during the second quarter of 1996.



As of August 1996, the largest planned additions to retail space were in Atlanta, Miami, Tampa, West Palm Beach, Jacksonville, Orlando, Norfolk, Raleigh and Charlotte. Several Florida metro areas had also planned sizable new additions to other commercial space last August, including Fort Lauderdale, Miami, Jacksonville, and West Palm Beach.

Implications: *Persistently high office vacancy rates in some Florida markets this late in the business cycle are a risk.* With a significant portion of regional institutions' assets in these markets, caution is warranted.

Norman Williams, Boston Regional Economist

PROTOTYPE

Financial and Commodity Markets

- **The Treasury yield curve remains steeper than at the beginning of 1996, but it has flattened since July.**
- **The Atlanta Region's stock index has outperformed the S&P 500 so far this year, but it has underperformed the S&P Composite Bank Index.**
- **Evidence suggests that changes in the slope of the short-end of the yield curve may be a good predictor of bank stock performance relative to the broader market.**
- **New yield curve spread futures and options offer an alternative to managing exposures to twists in the yield curve.**
- **Favorable forecasts and a drop in exports have driven grain prices lower.**

Changes in Interest Rates and Bond Values

As reflected in Chart 1, the yield curve has steepened and then flattened this year. The 30-year Treasury yield peaked on June 12 and July 5 at 7.19 percent -- 124 basis points higher than at the beginning of 1996. It has since fallen to 6.40 percent.

To demonstrate the impact that interest rate fluctuations may have had on the market value of a bank's fixed income portfolio, Table 1 presents three types of fixed income securities common to a bank's portfolio: a Treasury bond, a FNMA mortgage pass-through, and a callable FNMA Agency bond. The value of each bond was computed on January 1, July 1, and November 25, 1996. Table 1 lists the percent change in the value of each bond between those dates.

Together the bonds lost nearly 5.27 percent of their value through July 1, 1996, but they recovered 2.74 percent by November. Through the eleven months ending in November, the value of the three-bond portfolio was down 2.68 percent. On an aggregate basis, the Atlanta Region's banks fared better. The value of securities holdings for all Call Report filers in the Region declined by 1.28 percent for the nine months ending in September. Obviously each institution's investment portfolio performance will vary depending on the types of instruments held and the original acquisition price of

CHART 1

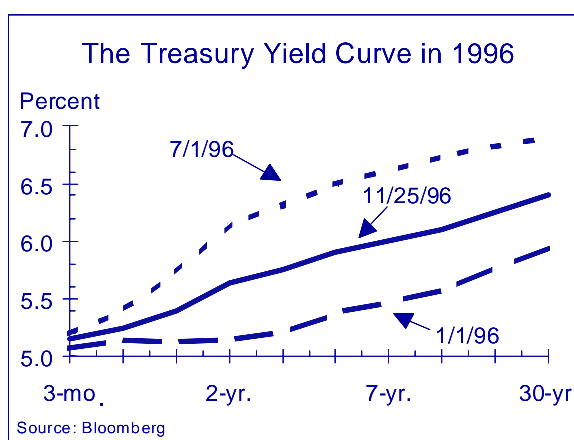


TABLE 1

EXAMPLE OF RECENT BOND PERFORMANCE								
	US TREASURY 30-YEAR BOND $100,000 PAR 7.25% COUPON 7.75 YRS UNTIL MATURITY		FNMA MORTGAGE PASS-THROUGH $100,000 PAR 7.5% COUPON 7.59 YRS WAL		FNMA CALLABLE AGENCY BOND $100,000 PAR 7.55% COUPON 7.58 YRS UNTIL MATURITY		TOTAL	
DATE	PRICE	CHANGE FROM PRIOR PERIOD	PRICE	CHANGE FROM PRIOR PERIOD	PRICE	CHANGE FROM PRIOR PERIOD	PRICE	CHANGE FROM PRIOR PERIOD
11/25/96	$107,375	3.84%	$100,280	2.19%	$102,240	2.14%	$309,895	2.74%
7/1/96	$103,406	(7.08%)	$98,130	(3.90%)	$100,100	(4.68%)	$301,636	(5.27%)
1/1/96	$111,281		$102,110		$105,020		$318,411	

SOURCE: Bloomberg

PROTOTYPE

each instrument.

The Atlanta Region's Bank Stock Performance

The stock market generally reacts unfavorably to rising interest rates, and reflecting this, the S&P 500 gained only slightly more than 3 percent through July (the latest peak in long-term rates). Since July the decline in rates has propelled the S&P 500 to new record levels, up 21 percent this year. The S&P Bank Index, however, has performed well for most of the year, despite the period of rising rates that occurred during the first two quarters of 1996.

The stellar performance of the money center banks this year -- with Citicorp and Chase Manhattan alone up over 60 percent on the year -- caused the S&P Bank Index to outperform indexes that track the performance of the Atlanta Region's banks. The Atlanta Regional Bank Index (ARBI), created by the Division of Insurance (DOI), consists of the Atlanta Region's 37 members of the American Banker Bank Index, which includes the 225 largest publicly-traded banks or bank holding companies. *The ARBI, which is weighted by total market value of shares outstanding, has gained 34 percent on the year, with performance closely tracking the S&P Bank Index.* The ARBI shares its four largest institutions with the S&P Bank Index: Barnett Banks, First Union, NationsBank, SunTrust, and Wachovia.

Do Yield Curve Spreads Provide a Peek at Future Bank Stock Performance?

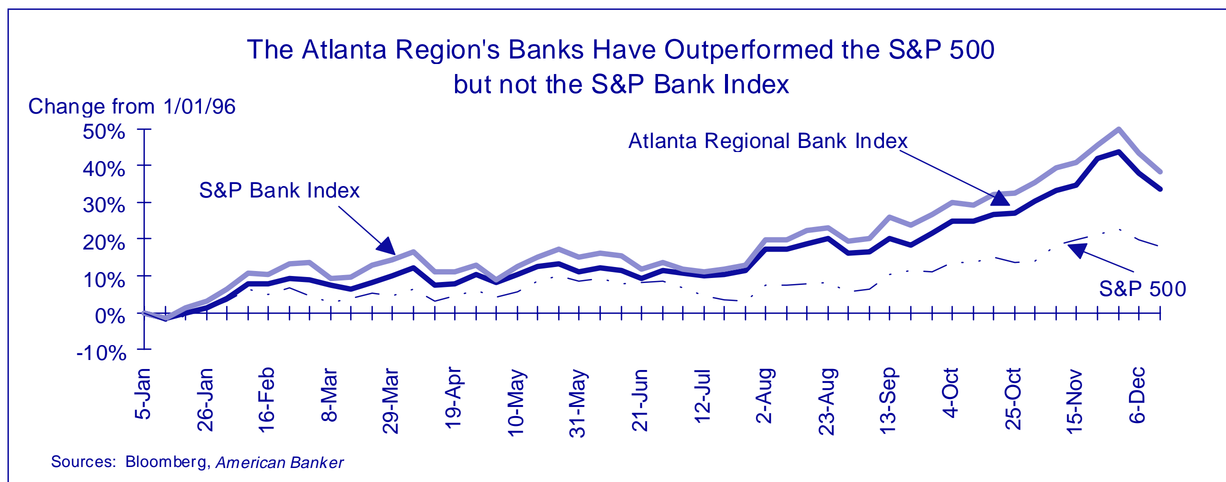
A recent study by Merrill Lynch suggests that the slope of the short-end of the yield curve is a useful predictor of near-term bank stock performance relative to the broader market. For the period 1950 through 1995, the median performance of bank stocks in the study's universe outperformed the broader S&P 500 index 76 percent of the time in the twelve months following a widening of spreads between the 5-year and 3-month Treasuries. In contrast, the median underperformed the broader market 75 percent of the time in the twelve months following compression in the 5-year and 3-month spread. Chart 3 on the following page plots this concept through 1995.

The results of this study are intuitive. A steepening yield curve favors widening interest margins. The opposite is true as the yield curve flattens.

Did the change in the 5-year/3-month spread over the previous year portend the recent strength in bank stocks? Not in this case. For the twelve months ending October 1996, bank stock performance relative to the broader market was strong despite a decline of nearly 200 basis points in the 5-year/3-month spread during the preceding twelve months.

This recent departure from the historical pattern may have resulted from the market's recognition of widespread cost-cutting and "right-sizing" programs, as well as merger and acquisition activity. Also, bank stock performance has been buoyed by the use of excess funds to repurchase outstanding shares at many institutions, which drives earnings per share higher.

CHART 2



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A New Product for Managing Exposures to Yield Curve Twists

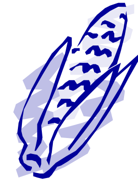
Managing earnings exposures to changes in the yield curve typically requires altering cash market positions, executing customized financial derivatives, or contracting multiple positions in exchange-traded derivatives instruments. *Recently, the Chicago Board of Trade (CBOT) introduced new products that may eventually simplify managing this risk -- Yield Curve Spread Futures and Futures Options (YCSF).*

YCSF contracts are structured so the payoff changes only in response to changes in spreads between points along the Treasury yield curve, rather than shifts in the overall level of interest rates. These instruments may provide advantages over hedges involving multiple positions in interest rate derivatives that attempt to isolate spreads along the yield curve. Ten futures contracts with spreads that cover the 2-, 3-, 5-, 10-, and 30-year maturity points were initially approved for trading. Options on these contracts also are traded.

In theory, YCSFs could be used to construct hedges for specific interest-sensitive securities, or more macro hedges based on an institution's overall balance sheet structure. Regardless of how they are used, a great degree of sophistication would likely be needed to construct meaningful hedges. Insured institutions that execute YCSF contracts should be cognizant of the fundamental risks identified in the FDIC's supervisory policy addressing financial derivatives.

Initial trading in the YCSFs has been thin and for some contracts non-existent. A CBOT representative indicated that position holders have been fairly diversified with most of the volume derived from speculators and traders for proprietary accounts.

Favorable Forecasts, Fewer Exports Drive Grain Prices Lower



Many market observers were surprised by a mid-November USDA report that projected near-record corn and soybean crops this year. Favorable weather during the late harvest pushed estimated corn production for the 1996/1997 crop year to 9.27 billion bushels -- the third best harvest behind those of 1992 and 1994. *The USDA expects strong corn yields over much of the Corn Belt and record yields in Nebraska, Kansas, and Missouri.* Likewise, soybean production is forecast to total 2.4 billion bushels -- second only to the 1994 harvest.

As expected, prices for corn continued to slide from their summer highs, which were driven by fears of supply shortages, late planting, and late harvest risks. Weaker corn and soybean prices, the second largest spring wheat harvest on record, and favorable weather conditions for the recently planted winter wheat crop also have softened wheat prices. (See Chart 4) Further compounding price declines has been a drop in demand from abroad as global competition heightens. *Domestic corn and wheat producers are facing increased production, aggressive marketing, and foreign export subsidies from competitors including Argentina and the European Union.* Soybean exports appear more favorable as Pacific Rim purchases of soybean meal to feed expanding livestock herds accel-

CHART 3

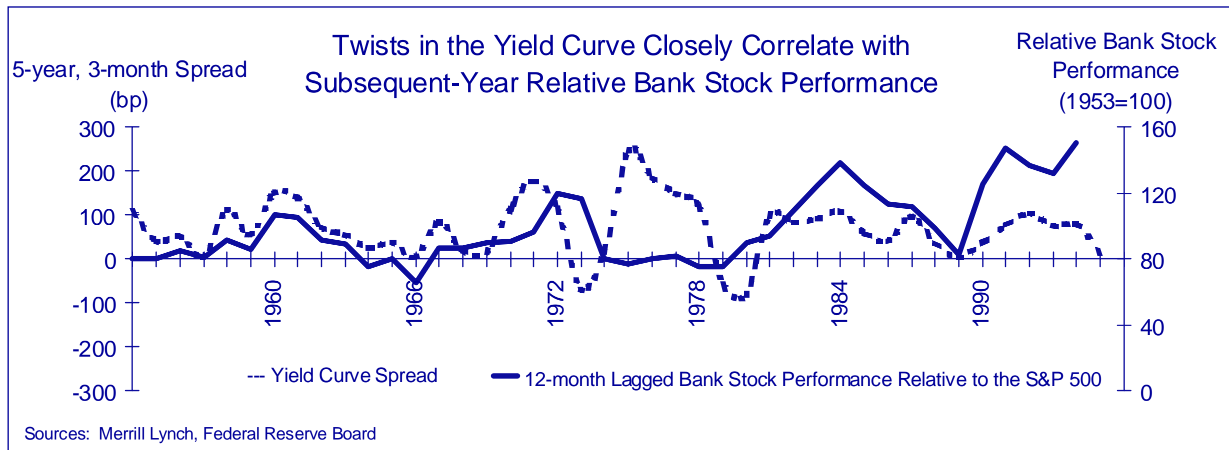


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Chart 4

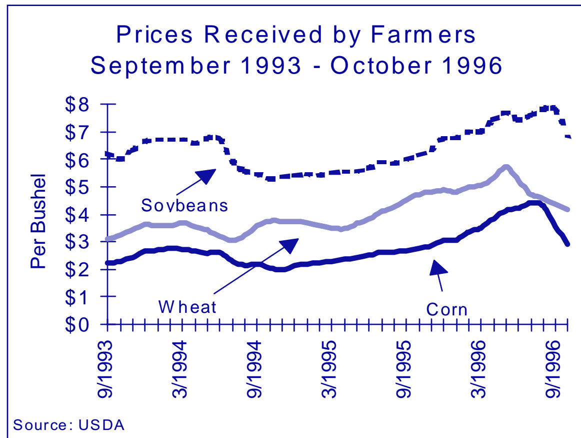


Table 2

Major Commodity Rankings Based on 1994 Cash Receipts	AL	FL	GA	NC	SC	VA	WV
Briolers	1		1	1	1	1	1
Cattle	2		5		4	2	2
Nursery	5	2		4	3		
Tobacco				3	2	5	
Chicken Eggs	3		4				5
Cotton	4		3		5		
Turkeys				5		4	3
Dairy		5				3	4
Oranges		1					
Hogs				2			
Peanuts			2				
Sugar Cane		3					
Tomatoes		4					

Source: USDA

erate and as South American competitors face lower than expected production.

According to the USDA, average prices for all three crops for the current marketing year are expected to fall from the average of the previous year, but should remain favorable relative to the average price received over the previous five marketing years. Futures markets generally agree with these predictions with some contracts that mature over the 1996/1997 marketing year recently trading approximately 30 percent below their respective contract highs reached earlier in the year.

Provided livestock and milk prices continue their recent ascent or stabilize, declines in feed costs should improve profit margins for livestock and dairy farmers. This is especially good news for cattle operators who faced falling cattle prices and rising feed costs earlier in 1996. Table 2 shows the major agricultural commodities for states in the Atlanta Region.

The prospect for timely repayment of production loans to the Region's agriculture banks appears good based on the current expectations for operating income. Cash flows for many crop producers also should be supported by the first of seven fixed-support payments under the 1996 Farm Bill.

Allen Puwalski, Banking Analyst
Steven E. Cunningham, Senior Financial Analyst

Current Regional Banking Conditions

- **Bank profitability dips slightly but remains high; however, thrift profits plunge during the third quarter due to the one-time SAIF assessment.**
- **The special assessment to capitalize the SAIF will cost 387 institutions in the Atlanta Region $650 million.**
- **Unprofitable institutions in the Atlanta Region increased from 70 to 121 during the third quarter, largely due to the SAIF assessment.**
- **Loan growth at commercial banks within the Region exceeds the nation, paced by strong growth in credit card loans, residential mortgage loans and construction and development loans.**

Given the generally favorable economic conditions throughout the Region, most banks and thrifts in the Atlanta Region performed well during the third quarter despite the special assessment for the capitalization of the SAIF. Chart 1 depicts the quarterly return on assets (ROA) and return on equity (ROE) for commercial banks and thrifts since the third quarter of 1995.

Third-quarter Performance

Banks earned a quarterly ROA of 1.21 percent. This return matches nationwide results but is down slightly from 1.25 percent a year ago. *Strong earnings continue to drive capital ratios higher with the leverage ratio at an all-time high of 7.91 percent, or 22 basis points above the national average.* The quarter's ROE was above 13 percent; banks in this Region have posted a double digit ROE since the fourth quarter of 1991.

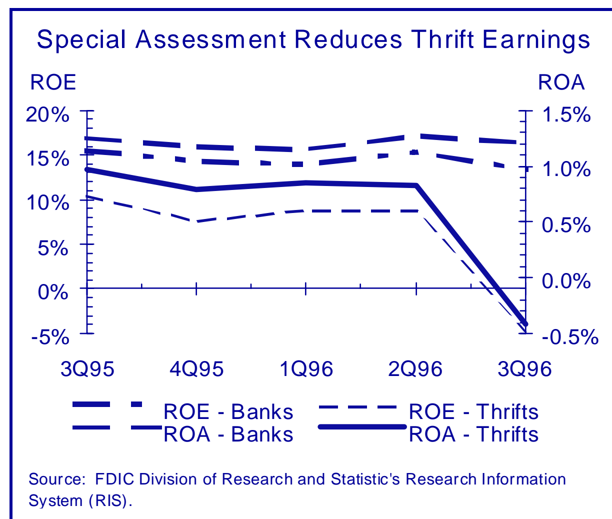
The quarterly results are impressive given a significant rise in provisioning expense, which almost doubled from a year ago. Relative to assets, the quarterly provision expense increased from 22 basis points to 43 basis points. The increased provisioning was needed to offset rising net charge-offs, mainly from consumer and credit card loans.

For all banks within the Region, charge-offs have increased from 0.34 percent of loans at year-end 1995 to 0.45 percent. The increase in credit card charge-offs, however, has been much higher, from 3.15 percent to 3.82 percent. *Charge-off rates have differed among banks by asset size. Larger banks, those with assets of $500 million or more, have a credit card charge-off rate of 3.85 percent and overall charge-off rate of 0.49 percent.* In contrast, smaller banks, those with assets of $500 million or less, have only written off 2.78 percent of their credit card loans and 0.25 percent of total loans.

The SAIF assessment drove the quarterly ROA for thrifts and savings banks to a negative 0.42 percent, which is well below the national loss of 0.05 percent. Despite the loss, however, the Region's thrifts did manage to set an all-time high for the quarterly net-interest margin of 3.72 percent. Similar to banks, thrifts showed a large increase in charge-offs and the provision expense. The quarterly provision expense more than tripled from 15 basis points a year ago to 56 basis points. On a positive note, lower assessment rates provide much improved earnings prospects going forward. *Despite the large quarterly loss, the thrift leverage ratio only dropped 21 basis points to 8.88 percent. Thrifts had a quarterly negative ROE of 4.64 percent, the lowest return since the third quarter of 1991.*

The SAIF assessment was the driving force in a 90

CHART 1



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percent increase in quarterly noninterest expense at thrifts. However, even without the special assessment, noninterest expense grew 17 percent, which exceeds the 10 percent growth rate recorded during the first six months of 1996. This suggests that some thrifts elected to bundle some other charges with the SAIF assessment. A portion of the rise in overhead results from an increase in the number of thrift employees. Thrift employees number 20,517, up from 19,372 a year earlier. This 5.9 percent growth in thrift personnel is not markedly higher than the 4.2 percent increase at banks; however, thrift assets have shrunk by almost 11 percent since last year while bank assets have expanded by 9.5 percent.

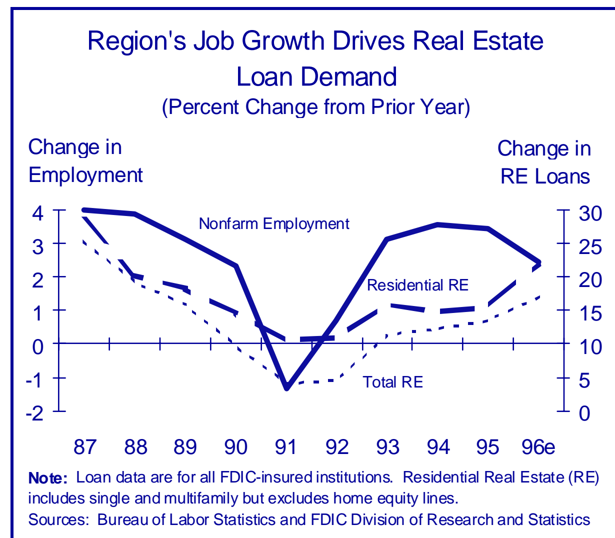
Commercial Bank Loan Portfolios Experience Strong Growth

Robust loan growth continued during the quarter with total loans at commercial banks increasing $53.9 billion or 13.5 percent from a year ago. Nationwide, loans increased only 7.1 percent. *Within the Region, most major loan categories have expanded at a double-digit growth rate since last year.* Credit card loans grew by nearly 32 percent, which was by far the highest growth rate. The two next highest growth rates were for residential (1 to 4 family) real estate loans at 21 percent and construction and development loans at 19 percent.

In conjunction with vigorous loan growth, there has been a shift in the distribution of loans from a year ago. *Real estate loans have remained steady as a percentage of total loans, but there has been a shift within this category with construction and development and residential lending increasing their share of the total.* Relative to real estate loans, residential loans have increased from 51.5 percent a year ago to 54 percent and construction and development loans have grown from 7.9 percent to 8.2 percent. The growth has come mainly at the expense of nonresidential real estate loans, which have declined from 29 percent to 26.6 percent. Historically, the growth rate of residential real estate lending has been closely linked with employment growth (see Chart 2).

Examiners indicate that most banks within the Region are actively soliciting new loans. Moreover, they see a slight increase in the number of banks underwriting speculative construction projects and extending credit to less credit-worthy consumers.

CHART 2



Note: Loan data are for all FDIC-insured institutions. Residential Real Estate (RE) includes single and multifamily but excludes home equity lines.
Sources: Bureau of Labor Statistics and FDIC Division of Research and Statistics

Impact of Special Assessment

According to preliminary figures supplied by the FDIC's Division of Finance, 387 institutions within the Region will pay about $650 million for the special assessment. A breakdown of this total shows that commercial banks will pay a greater share of the total than thrifts. In the Atlanta Region, 143 commercial banks in the Region will pay $386 million, and 244 thrifts and savings banks will pay $263 million.

The average bill for commercial banks is $2.7 million, but drops to $1.8 million if the highest two payers are excluded. Among commercial banks, the assessment is concentrated as six companies will pay about $284 million or 74 percent of the $386 million bank total. For thrifts and savings banks, the average assessment is much lower and is less concentrated among the top two payers. The average bill is $1.08 million and the two highest will only pay $33.5 million or 12.7 percent of the $263 million thrift total. *Although thrifts have a smaller average bill, the assessment does represent a much larger share of their capital — 4.85 percent of thrift equity compared to 0.67 percent of commercial bank equity.*

Unprofitable Institutions on the Rise

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Although the SAIF special assessment is a major factor for the institutions that are reporting a loss for the first nine months of the year, there may be some concern for the institutions that experienced a loss larger than their SAIF assessment. *A total of 23 institutions had a pre-tax loss (17 after-tax, assuming a 40 percent marginal tax rate) larger than their assessment, which is up from just five institutions a year ago.* In nearly all instances, higher loan loss provisioning, arising from sharply higher consumer loan charge-offs, was the leading cause underlying the loss. These institutions may need monitoring, as the generally favorable economic and banking conditions throughout the Region will not persist indefinitely.

Jack M.W. Phelps, Senior Regional Analyst

PROTOTYPE