McTevia analyses effects of Wall Street fallout on local, regional banks for Crain's Detroit Business

Regional, community banks to feel Wall Street fallout

By Tom Henderson

Continuing turmoil in national markets will mean a longer period of suffering for regional and community banks, which have already been hit by sharply lower share prices and ongoing large write-offs because of commercial real-estate loans gone bad, say local experts.

Amiyatosh Purnanandam, an assistant professor of finance at the University of Michigan, said that the share prices of local banks likely won't fall much because of the bankruptcy filing of Lehman Brothers Holdings Inc. on Monday and the purchase of Merrill Lynch & Co. by Bank of America Corp., but that continued uncertainty in national markets will continue to limit the availability of credit and to hurt the chances of undercapitalized banks to raise money to fix their balance sheets.

"The turmoil on Wall Street will make their recovery slower. Banks that are suffering will hurt for much longer than I would have thought two months ago," he said.

Purnanandam said that the decision by federal regulators to let Lehman fail would hurt in the short run and be beneficial long-term. "Lehman failed because of extremely high leverage and its investments in risky mortgage-backed securities," he said. "Even a small drop in the asset value can wipe out the entire equity capital of a leveraged financial institution that operates with the kind of debt equity Lehman had, which was about 30 to one.

"The Fed is finally sending the right signal to the market by not participating in further bailouts. Though financial markets may experience short-term pain in the long run, this is a prudent move in the long run," he said, referring to the Federal Reserve Bank. "The Fed cannot be in the business of bailing out private businesses. It raised the issue of moral hazard. If they get bailed out today, they'll expect to be bailed out tomorrow, and they'll continue to go out and take too many risks."

"There will be a major shakeout in regional and local banks," said Jim McTevia, managing member of McTevia & Associates L.L.C., a Bingham Farms-based turnaround and consulting specialist. "Their loan work-out departments are working full time trying to salvage something from their portfolios, but their reserves are shrinking dramatically."

As they run out of capital and have trouble raising more to shore up their balance sheets, they'll look to be acquired, or may be forced out of business by regulators, he said.

McTevia said Wall Street and its recent splurge on complicated financial derivatives shouldn't be blamed for the current turmoil.

"It's not a government problem. It's not an institutional problem, it's a consumer problem," said McTevia, who wrote a book 15 years ago titled Bankruptcy: A Society Living in the Future.

"Boy, did that come home to roost," he said. "Everyone was leveraged. We lived so far in the future. We became a debtor society and now we're paying for it. The consumer has got to get back to basics and live within his means, even if it means lowering his standard of living."

Thomas Shafer, president of the southeast region of Flint-based Citizen's Bank, said that access to capital for local banks hoping to fund loans, already difficult, will get even harder over the next six months.

"There's less capital available, now, and it's going to be an increasing problem," said Shafer. "Investors are being very cautious."

He said although local banks may be cheap relative to historical standards, he doesn't think there will be much merger or acquisition activity in the short term. "Market growth opportunities will be outweighed by credit risks," he said.

Shafer said would-be purchasers will likely choose to play it safe, see how the credit troubles play out and choose to pay a higher price later if they decide to go after acquisitions, rather than buy cheap now and take on more risk.

The Wall Street turmoil is also yet another challenge for those seeking loans.

"It's just another very bad piece of rotten wood on the pile," said Dennis Bernard, president of Bernard Financial Group in Southfield.

The collapse of Lehman, the government bailout of mortgage giants Fannie Mae and Freddie Mac and the weakening of giant-insurer American International Group Inc. are making already tight credit markets even more difficult, Bernard said.

"Most national permanent lenders are not lending, and when they do start lending again in a few weeks, they will be even more conservative, they will continue to be anti-Michigan and their spreads will continue to widen."

"Lehman, and all the other Wall Street firms for that matter, have shut off real estate lending pretty much about 9, almost 12 months ago,"said Adam Lutz, president and CEO of Farmington Hills-based iCap Realty Advisors.

Prior to the collapse of the commercial mortgage-backed securities market, Lehman Brothers acted as a conduit, or a lender that would originate and package loans billions of dollars in loans and sell them off. But with the implosion of the mortgage-backed securities market in 2007, Lehman cut off its commercial real estate lending.

McTevia said things in the banking business will get better before they get worse. "Twelve months from now, we'll have most of this behind us, but boy is it going to hurt . . . It's like what Jack Palance said to Billy Crystal in the movie `City Slickers:' `The day isn't over, yet, Shorty.' "