

## Rattling the Hornet's nest

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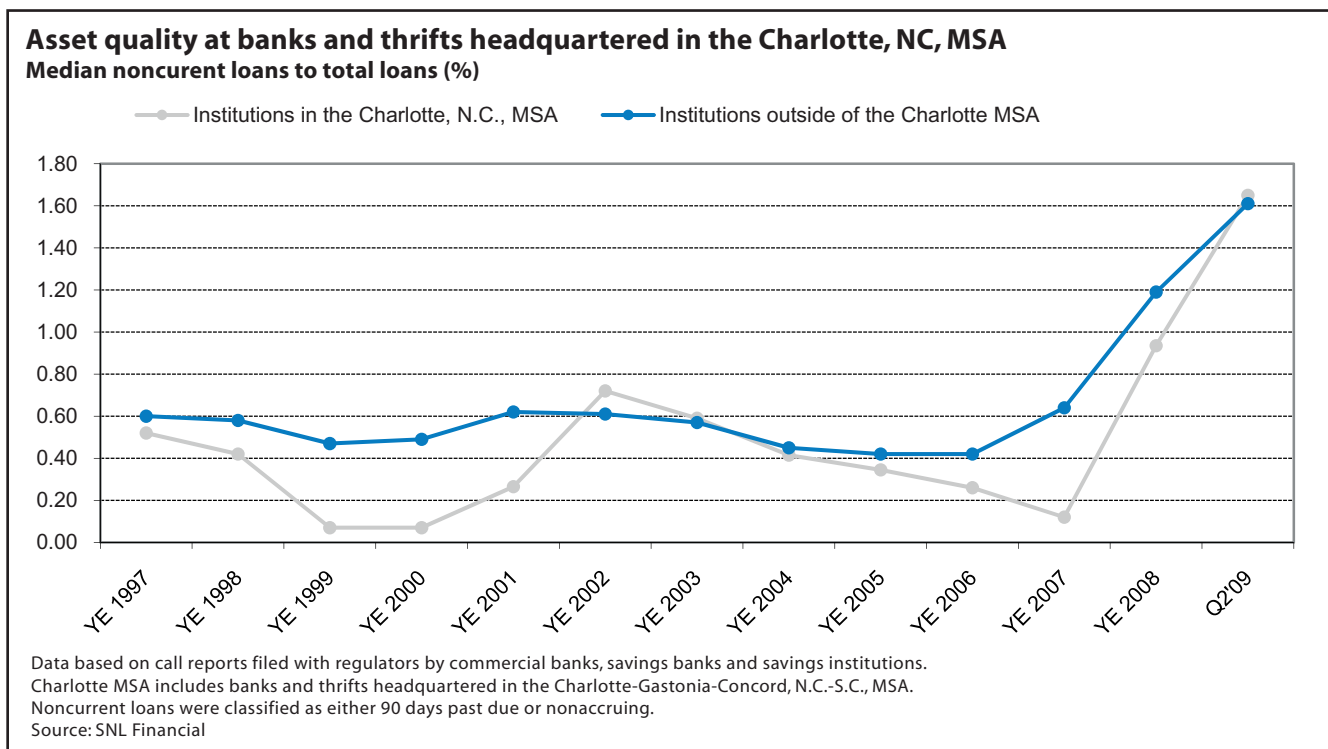
By Nathan Stovall

Stress in the Charlotte, N.C., market, long considered a safe haven from the credit crisis, is starting to catch up with the rest of the country.

Tumultuous market conditions, a myriad of issues facing Bank of America Corp. and the sale of Wachovia Corp. to Wells Fargo & Co. have put Charlotte's benign banking environment under pressure. But the lack of a speculative run-up in home prices and favorable demographics have left the city in better shape than many other

areas in the Southeast and probably healthier than many would have expected when looking at the tremendous change facing the market a year ago.

Stability in the Charlotte housing market has made it an area of relative strength in recent years. For instance, through June 30, 2008, home prices in the Charlotte metropolitan statistical area maintained increases, actually rising 5.24% year over year, while home prices declined 4.80% nationwide, according to the Federal Housing Finance Agency. In the year that followed, home prices in the Charlotte MSA fell just 1.72%, compared with a 6.13% decline across the U.S.



Buoyed by the relative strength in the local housing market, the credit quality of Charlotte-based banks has outperformed that of the rest of the country for several quarters. The level of noncurrent loans, or loans more than 90 days past due plus nonaccrual loans, at banks based in the Charlotte MSA, excluding BofA, averaged 0.66% of loans and leases in the second quarter in 2008, compared with a 1.63% average at banks headquartered elsewhere in the U.S., according to SNL data.

But the outperformance of banks' credit quality in the market has dissipated as employees from two of Charlotte's largest companies — BofA and Wachovia, now Wells Fargo — have seen their incomes decline or possibly found themselves out of work. Local retail shareholders of the two banks experienced sizable decreases in their wealth as the two banks' stock prices dropped dramatically and the institutions' dividends went to nearly zero.

"What has been absolutely devastating is the loss of the dividend," Bob Morgan, president and CEO of the Charlotte Chamber of Commerce, told SNL. "You have a lot of shareholders that are employees, retirees, investors, foundations and trust funds, and nonprofits and for-profits who have invested in these two organizations and the dividends are basically gone as part of the TARP. There is a tremendous amount of wealth — here yesterday, gone today — and we, the community, are still dealing with that reset."

Some local shareholders have even filed lawsuits against former Wachovia executives, alleging fraud, negligent misrepresentation and other offenses.

With the new pressure on the market, noncurrent loans at banks based in Charlotte rose to a median of 1.65% of loans at the end of the second quarter from 0.94% at year-end 2008. Those levels compare to median noncurrent loans at banks headquartered elsewhere

in the U.S. of 1.61% at the end of the second quarter and 1.19% at year-end 2008, according to SNL data.

Like many other markets in the Southeast, construction and land development loans have caused the largest problems for banks in the Charlotte MSA. Yadkin Valley Financial Corp., which moved into the Charlotte market with the purchase of American Community Bancshares Inc. earlier this year, has had to work through residential speculation exposures in the area that it inherited with the acquisition.

Joseph Towell, chief credit officer at Yadkin Valley, said during the company's second-quarter earnings call in mid-August that Ameri-

can Community's portfolio makes up close to 25% of the company's total loan portfolio, but accounts for roughly 40% of its nonperforming assets. He said Yadkin Valley is learning it will take longer to work out some of those credits than it had anticipated because the jumbo mortgage market remains closed and few buyers have the financial wherewithal or desire to pull the trigger and purchase properties.

In September, Towell said at a Rodman & Renshaw investor conference that Charlotte is the weakest market in the bank's footprint. "It's directly related to what is going on with Wells and Wachovia and BofA and so on," he said.

### Noncurrent and past-due loans at banks and thrifts by loan type

	30 to 89 days past due (%)		Noncurrent* (%)		Total delinquent** (%)	
	Charlotte MSA	Rest of U.S.	Charlotte MSA	Rest of U.S.	Charlotte MSA	Rest of U.S.
Construction and land development	2.59	2.89	12.83	13.53	15.42	16.42
1-4 family (first mortgage and home equity)	3.38	2.35	6.74	5.25	10.12	7.60
Multifamily	0.96	1.23	3.43	3.12	4.39	4.35
Commercial real estate <sup>^</sup>	1.12	1.16	4.40	2.75	5.52	3.91
Commercial and industrial	0.68	0.96	2.36	2.88	3.04	3.84

As of June 30.

<sup>^</sup>Thrifts are not included in this loan type.

\*Noncurrent loans are loans classified as either 90 days past due or nonaccruing.

\*\*Total delinquent includes loans 30 to 89 days past due, 90 days past due and nonaccrual loans.

Charlotte, N.C., MSA includes banks and thrifts headquartered in the Charlotte-Gastonia-Concord, N.C.-S.C., MSA.

Data based on call reports filed by commercial banks, savings banks and savings institutions.

Source: SNL Financial

Recent weakness in the Charlotte MSA has also caused some problems for Citizens South Banking Corp. Howe Barnes Hoefer & Arnett analyst Mark Muth said in report reviewing the company's second-quarter earnings that "steep economic deterioration" in the Charlotte region over the past quarter caused nonperformers to rise to 1.97% of loans and other real estate owned in the period. Sandler O'Neill analyst Kevin Fitzsimmons further noted in an Oct. 1 report previewing the company's upcoming third-quarter earnings print that he expected Citizens South to build reserves to prepare for higher credit losses, largely related to residential construction, acquisition and development loans "as the Charlotte housing market continues to slow." He said, as unemployment is on the rise, stress could also occur in other segments such as retail commercial real estate, residential mortgage, home equity and consumer loans.

Unemployment levels in Charlotte have risen considerably and are above the August national unemployment rate of 9.7%. Unemployment in the Charlotte MSA stood at 11.8% in August, down from 12.4% in July, but up from 6.9% a year ago. The problems at Wachovia and BofA have contributed to the job losses, though the Charlotte chamber's Morgan said the institutions have only let go about 2,000 people thus far, or just above 5% of the employment base in Charlotte. He acknowledged that many of those positions were high-paying jobs, taking quite a bit of purchasing power out of the market, but initial estimates for job losses were far higher.

Developers almost certainly expected some of those positions to support high-rise condominiums built in downtown Charlotte. When driving through downtown, it is obvious that construction has

been heady over the last year, but also clear that three large condo towers are in various states of pause.

New office buildings have also changed the skyline, with six buildings under construction that will add close to 2.79 million square feet of office space in the area, according to Center City Partners, an organization that promotes economic and cultural development in Charlotte's urban core. Tenants are already slated for some of that space, but 1.15 million square feet are still available, Center City Partners said.

Charlotte boasted one of the lowest office vacancy rates in the U.S. earlier this year, when it stood at 2%. But that rate is projected to be 10% to 12% by mid-year 2010, according to the Charlotte chamber. Some of that could come from the new 48-story building under construction that Wachovia financed and planned to serve as anchor. Those plans changed when Wachovia sold to Wells Fargo, and while Duke Energy stepped up its commitment to serve as the building's main tenant, 300,000 to 400,000 square feet of office space are still available.

Wachovia had guaranteed the tax value of the building, and some of those taxes were going to be used for the construction costs of two museums in downtown Charlotte, Morgan said. Had Wells Fargo not swooped in to buy Wachovia and had the company simply sold its retail banking operations to Citigroup Inc., the remaining company might not be able to fulfill its tax obligations. Morgan also pointed out that local shareholders would have lost more in the Citigroup deal.

Shortly after the Wells Fargo deal was announced, Morgan as-

sembled a group of local business leaders, including former BofA Chairman and CEO Hugh McColl and CFO Jim Hance, to develop a target list of healthy institutions they planned to contact proactively and try to lure to the Charlotte area with its lower cost of living at 94% of the national average, low construction costs, attractive work force and relatively cheap, available office space. The group had some success, convincing GMAC Inc. and U.S. Bancorp to expand in the area.

Morgan is hopeful that Charlotte will remain the “can-do city” and continue to be a one of the more attractive banking markets in the Southeast and the entire U.S. He acknowledges that, in the short term, the community faces significant challenges, but still firmly believes that Charlotte represents a long-term safe haven for bankers. *i*