August 10, 2009

Banks Clip Commercial Loan Levels

Banks are balking at extending loans to real estate developers because of federal regulatory pressure on financial institutions to contain the volume of their commercial lending. That's forcing developers in search of refinancing to default on existing loans and, in turn, give the property to the banks. The problem stems from federal guidelines issued in 2006 from three bodies — the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and the Federal Reserve board of governors — that say banks should keep commercial real estate lending to less than 300 percent of their total capital. To meet that threshold, banks are left with two alternatives in closing the gap: raise equity from private sources or use earnings to write off loans, according to attorney Ernie Panasci of Jones & Keller in Denver, which represents several banks in the Western United States. "It's putting bankers' head in a vise and in a posture where they basically have an inability to lend," Panasci said. "The only thing bankers can do is get borrowers to pay off their loans and shrink the bank." Colorado ranked 11th nationally in terms of the loans carried as a percentage of capital, according to FDIC records covering the third quarter of 2008. In its battle to meet the guideline, Bank of Choice last week announced it had raised $15 million in private capital through a common-stock offering. It also boosted its loan-loss reserves by an additional $14 million in the first two quarters to cope with problem loans and declining real estate values. "Part of why we raised more capital is because we do have commercial real estate as a concentration in our portfolio," said Darrell McAllister, chief executive of Bank of Choice Holding Co. But not all banks can raise more money, leaving them to shrink loan portfolios. As a result, commercial real estate developers and homebuilders are feeling the impact. At best, some banks may find themselves in a squeeze for a couple of years as they try to meet the guideline. At worst, institutions face decades of work trying to come into compliance, some analysts say. All this as the Fed encourages banks to continue lending. In the end, banks must still answer to the regulators. "The regulators' mission is to make sure the bank is safe and sound. They don't want it to fail on their watch," said Don Childears, president of the Colorado Bankers Association. "That system means that, in our eyes, they overreact." The guidance was written as regulators worried that concentrations of commercial real estate lending were rising to levels that would create safety and soundness concerns in the event of an economic downturn. In the decade prior to the guidance, small to midsize institutions had the greatest increase in commercial real estate lending concentrations. At banks with assets between $100 million and $1 billion, concentrations doubled from about 156 percent of total risk-based capital in 1993 to 318 percent in the third quarter of 2006. The same was true at banks with assets of $1 billion to $10 billion: Levels rose from 127 percent to 300 percent of capital. Although the initial 300 percent threshold was not adopted formally by any federal regulatory agency, banks and regulators are behaving as if it had been — more so now, as markets tumbled. An inability to renew its loans was a contributing factor in Village Homes' bankruptcy filing last November, said Matt Osborn, its senior vice president of home building. "We'd been on two-year loans," Osborn said. "We re-upped and renegotiated terms every two years, and then that time frame rapidly started to shrink until, finally, the banks would not extend any further without significant adjustments to the terms. "We just couldn't make it work at the time," he said. It's nearly the same for Colorado Custom Homes CEO David Tschetter, who said he needs another $7 million to finish developing a 135-acre parcel in Windsor so he can start building homes. The parcel, for which he already owes $3.5 million, will have an appraised value of $17.6 million when infrastructure improvements are completed. That's all well and good — if Tschetter can get the funding. "Unless the bank is prepared to move the project forward, they'll end up owning it," Tschetter said. "I don't have a choice." The tale is playing out nationwide as commercial and residential developers find banks unwilling to refinance the loans that are coming due — even as the federal government bails out ailing homeowners defaulting on their loans. "Our members are really suffering," said David Ledford, senior vice president for housing, finance and land development at the National Association of Home Builders. "We're trying to help them, but progress is glacial at best." The organization plans to unveil a legislative proposal in the coming weeks, Ledford said, aimed at righting the industry. Jobs and local tax revenues are taking the hit, too, mostly from an inability to keep home builders operating. In a typical metro area, a project of 100 single-family homes generates an estimated $21.1 million in local income its first year, $2.2 million in taxes and other revenue for local governments, and 324 jobs. Thereafter, the project includes $3.1 million in local income each year, $743,000 in taxes and other revenue for local governments and 53 jobs. "Construction jobs are darn good jobs," said Mark Dotzour, chief economist at the real estate center at Texas A&M University. "The sales tax revenue produced by every home is good stuff, retail sales tax is good stuff, property taxes are good stuff. "But that's all at the local level," he added. "The federal government doesn't get much benefit out of a new home, and if they can't figure out the benefit, they're not interested." **(Denver Post)**

Colorado in Growth Mode, says Creighton's Goss Business Index

An indicator of expected business activity in Colorado moved above "growth neutral" in July for the first time since last September, Creighton University economist Ernie Goss said Monday in his monthly regional Business Conditions Index survey. However, Goss said he anticipates further job losses in Colorado through the fourth quarter. July's business index for Colorado -- based on a survey of supply managers in the state -- reached 51.1 in July, up from June's 42, May's 44 and April's 38, said Goss, head of the Goss Institute for Economic Research, which conducts the survey. The index ranges between 0 and 100. An index greater than 50 indicates expectations of an expanding economy over the next three to six months; 50 is growth neutral. The last time Goss' Colorado index exceeded 50 was in September 2008, when it reached 58.5. Goss said that the Colorado survey for July broke down this way:

New orders: 57.3.
Production: 56.3.
Delivery lead time: 53.5.
Inventories: 42.3.
Employment: 46.2.

"I expect the state’s seasonally adjusted unemployment rate to peak at 8.2 percent, its highest level since 1988, in the fourth quarter of this year," Goss said in his report. Colorado's official unemployment rate was 7.6 percent in June, with July figures due out in mid-August. "Colorado will continue to lose manufacturing jobs, both durable and nondurable, in the months ahead," Goss added. "However, the pace of these job losses will diminish significantly from the rate experienced earlier this year." The Goss Institute uses the same methodology for its survey as the Institute for Supply Management, formerly the Purchasing Management Association, in its national survey of its members. Goss separately released a three-state composite index that includes Colorado, Utah and Wyoming. Across the three-state region, the Business Conditions Index stood at 51.5 in July, up from 41.4 in June and 38.9 in May. "Readings over the past several months indicate that the region's leading economic indicator has bottomed out," Goss said, adding that he expects his index will "continue its upward trend in the months ahead." **(Denver Business Journal)**

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Rental Vacancies up; Rents Decline

Metro Denver apartment vacancies are at their highest level in four years, increasing for the sixth consecutive quarter, a report issued Thursday shows. The overall vacancy rate for the second quarter rose to 9 percent, up from last year's second-quarter rate of 6.2 percent, according to the report released by the Apartment Association of Metro Denver and the Colorado Department of Local Affairs' Division of Housing. Vacancy rates were at their highest level since they reached 9.3 percent during the first quarter of 2005, the report shows. The average rent was $870, its lowest point since the first quarter of 2008, when it was $861. The increase in vacancy rates is closely tied to job losses, said Ryan McMaken, a spokesman for the Housing Division. "There were over 55,000 jobs lost last year in Denver," he said. "Even if that's overestimating, that's a lot of jobs, and that translates into a lack of demand for rental units. Without job growth, you're not going to have a lot of demand for rental housing." Apartment vacancies nationwide climbed to 7.5 percent in the second quarter, their highest level in 22 years, according to Reis Inc., a New York-based real-estate research firm. "Until we see the market come back from the standpoint of jobs and consumer confidence, it's going to be tough across the country," said Lauren Brockman of Orion Real Estate Services, an apartment-management company in Houston. The second quarter's average rent is down from $886 during the same time last year. Only the Boulder/Broomfield area reported an increase in the overall average rent, to $967. The highest average rent was in Douglas County at $1,000. The lowest was in Jefferson County at $812. Average rents for other counties were: Adams, $884; Arapahoe, $828; and Denver, $881. **(Denver Post)**

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July Same-Store Sales Plunge 5%

Later back-to-school sales, tighter inventory and weather hit July retail sales, with US comparable-store store sales declining by 5% from the same month of 2008, according to the International Council of Shopping Centers' monthly Retail Chain Store Sales Index. With Labor Day occurring on Sept. 7, school is beginning later in many areas, with the result that many back-to-school sales and tax-free holidays have shifted into August. "ICSC Research estimates that the later back-to-school selling trimmed about 0.5 percentage points from July's sales pace and will boost August by that same magnitude," wrote Michael Niemira, ICSC chief economist and director of research. Tighter inventory controls were a factor, noted Lorraine

Hutchison, specialty retail and department store analyst for Bank of America/Merrill Lynch in a conference call. Old Navy's sales were weaker, in part because of a lack of merchandise. "They had such a successful spring and early summer, they were light on inventory," Hutchinson said. JCPenney and Bon Ton also cited lower clearance inventory levels for their showings (down 12.3% and 9.8%, respectively). Weather, too, was a factor, with July's average temperatures running about 2 degrees cooler than last year, ICSC noted. Drug store sales were the only sector to report a gain in the ICSC Index, with comps rising 1.3%. Apparel stores comps declined 7.1% (with Abercrombie & Fitch reporting a 28% comp drop; Ross Stores reported a 4% gain), while department stores fell 9.6%. Luxury stores reported a 12.5% decline. Discounters reported a 4.1% drop, with Target posting a 6.5% decrease and TJX a 4% gain. "Continued weakness in apparel and home décor categories remains at the root of Target's sales challenge, though the retailer described its results as 'within expectations'," wrote Bryan Gildenberg, Chief Knowledge Officer of MVI, a Cambridge, Mass.-based retail consultancy. Wholesale clubs dropped 1.5% when fuel is excluded. Food deflation was a major factor at the warehouse clubs, as traffic remained healthy, said Robert Ohms, discount stores, apparel and footwear analyst at BOA/Merrill. Don't expect a major shift anytime soon, MVI warns. Consumers remain concerned about unemployment and are maintaining a higher savings rate of about 5%. The result will be "a rocky next few months for retailer performance," Goldenberg wrote. "The consumer in any way shape or form wants value," said Adam Rifkin, hardlines analyst of BOA/Merrill. "Things are certainly getting better compared to where they were six to nine months ago. But less bad is not necessarily good." Despite help from back-to-school shopping, ICSC Research anticipates an August comp-store decline of about 4% vs. last year. **(Globest.com)**

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U.S. Unemployment Eases at 9.4%; Job Losses Shrink

The nation's latest employment numbers, released Friday, were the most encouraging in months, showing a much smaller decline in jobs than earlier this year and even a slight drop in the unemployment rate. The U.S. jobless rate eased to 9.4 percent in July from 9.5 percent the previous month, the Labor Department's Bureau of Labor Statistics reported. And the nation's total non-farm employment fell by 247,000, the smallest decline since August. Over the last three months, U.S. employment losses have averaged 331,000 a month, versus an average of 645,000 over the prior six months, BLS Commissioner Keith Hall told Congress Friday. As recently as July 15, the Federal Reserve said it expected the U.S. unemployment rate to top 10 percent sometime in 2009 -- which, of course, it still could. Still, while the BLS figures suggest that the nation may be approaching the bottom of its recession-fueled employment plunge, they also show that the climb back up to more typical employment levels will be a long one. U.S. employment has decreased by 6.7 million since the recession officially began in December 2007, BLS said, and there were an estimated 8.8 million Americans working part-time in July who want to be working full-time. In particular, the construction and manufacturing sectors continue to show serious job declines, although smaller than a few months ago. "The best that can be said about the July jobs report is that it was less bad than in recent months," Raymond Keating, chief economist for the Oakton, Va.-based Small Business & Entrepreneurship Council, said in a statement. "The rate of job losses is slowing, but a decline of 247,000 in nonfarm payrolls is in no way good news. And

while the unemployment rate declined ever so slightly, ... that reflects, unfortunately, a notable decline in labor force participation." Keating said that while the economy's rate of decline is slowing, "an economic recovery and a jobs recovery ultimately will be all about small businesses. Unfortunately, all of the policy measures coming out of our nation's capital, and in many state capitals as well, have been negatives for entrepreneurs, small businesses and investors -- namely, bigger government crowding out the private sector, and the imposition or threat of higher taxes and increased regulation -- thereby making the recession deeper and longer than otherwise would be the case, and serving to restrain recovery once it starts."
In Colorado, the most recent jobs report, for June, showed the state's unemployment rate at 7.6 percent, unchanged from May. Colorado employers added 12,300 jobs in June, the Colorado Department of Labor and Employment reported. July numbers are due out in mid-August. In the Denver area, unemployment stood at 7.9 percent in June, up from 7.5 percent the previous month, the Labor Department reported July 29. The metro area lost 55,200 jobs during the year ended in June. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	1.50
3 MONTH LIBOR	.46	.54	2.80
PRIME RATE	3.25	3.25	5.00
10 YEAR TREASURY	3.89	3.31	3.92
30 YEAR TREASURY	4.61	4.20	4.56