

FDIC Down 400 Billion

This is the headline we may all see very soon. Check out Institutional Risk Analytics work (IRA) here: www.institutionalriskanalytics.com sourced from John Mauldin's Outside the Box. IRA takes the data from the FDIC crunches it with their own set of parameters. The FDIC has over 400 banks on their "watch" list. IRA gives 2,256 of those banks a failing grade by their calculations.

IRA predicts that over 1,000 banks are still on course to fold or be taken over in the foreseeable future. To date in 2009 a total of 92 banks have failed compared to 25 in 2008. IRA says we have 900 more to go. That's a huge number!

We're talking about \$4.46 trillion dollars insured assets tied up in the 400 rated "F" by the IRA. So far in this cycle, banks that have been taken over by the FDIC are showing losses of 25% and the IRA notes imply a cumulative loss of over 300 billion.

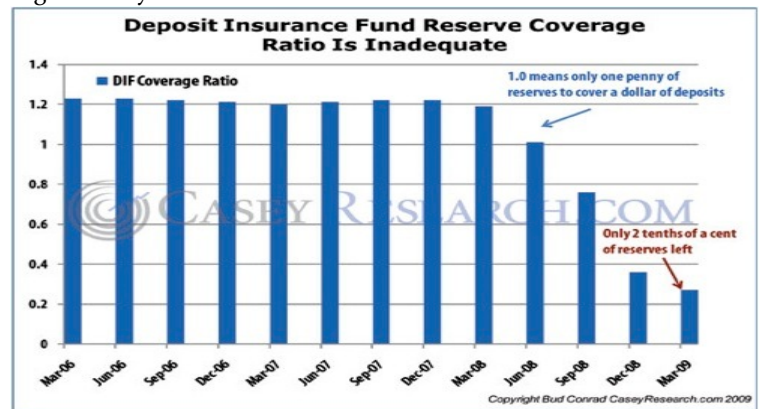
"If you start with the internal assumptions used by our firm that roughly half of the banks currently rated "F", or some 1,000 banks will fail and/or be merged with another institution and that the loss to the FDIC bank insurance fund will be approximately 20-25% of total assets, then the cost of these resolutions to the FDIC through the full credit downturn could be in excess of \$400-500 billion. Keep in mind, in making this alarming estimate, we ignore other banks currently in ratings strata above "F" and that some of these may fail as well. Our overall "worst case" or maximum probable loss ("MPS") for large US banks above \$10 billion in assets is \$800 billion through the current credit cycle."

From almost \$60 billion last fall, the FDIC's reserves have been drawn down to about \$10 billion today (after set-asides), a 16-year low. A quick look at the FDIC's own data shows how inadequate those reserves are compared to the deposits they are now insuring.

The FDIC has only about two-tenths of one cent for every dollar of assets it covers!!

Check the following chart from Conrad Casey Research. The FDIC can borrow \$100 billion in an emergency line of credit, and

through 2010 it can get another 500 billion. If and when that money is borrowed it will have to be paid back. Remember the money that was lost in the savings and loan crisis 20 years ago? The FDIC had to borrow a mere \$15 billion and we are still paying that 30-year loan back!



The FDIC has two options to replenish its insurance fund in the short run: it can charge banks higher fees or it can take the more radical step of borrowing from the US Treasury. It has already levied a "special fee" that garnered over \$5 billion.

A growing economy requires a growing credit market. Shrinking credit indicates a receding economy. But banks are having to raise capital. That means banks are having to curtail lending to some extent. The chart on the next page shows that loan growth was relatively smooth going back to 1947 and has not dropped significantly as it has in the past year. The data suggests that the banks that have problems and some others as well intend to keep reducing their loan exposure as they try to increase their capital.

Consumer credit-card lending is down. Banks have cut their outstanding and unused bank lines to corporations. Remember the money that the Fed used to purchase toxic assets so the banks could lend? They are increasingly using that money to buy Fannie and Freddie loans and banking the interest in an

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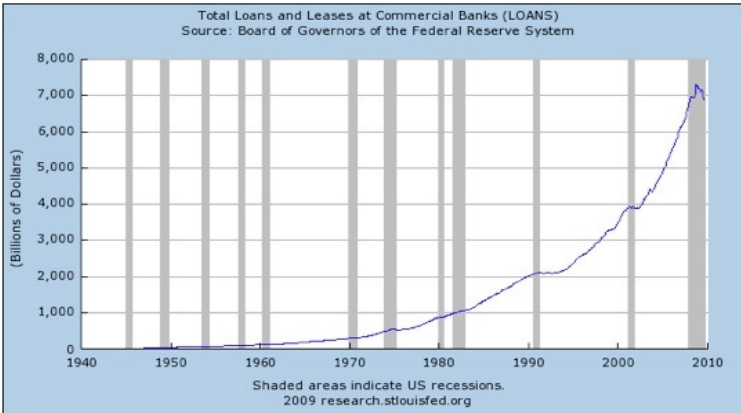
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effort to improve their profitability.



Why are they raising capital? Because their loan losses are high and rising. Consumer loan losses are rising and so far there is no sign of those losses topping out. The same can be said for real estate loans at commercial banks, running over 9% delinquent. These are loans banks kept on their books.

Commercial real estate loans are about to hit the fan and the write-offs may be as large as \$400 billion. This will force some banks to go under and others may simply have to absorb the losses.

Back to the FDIC. Sheila Blair, who heads the FDIC, has emphatically said the FDIC will not ask Congress for a capital

infusion. This means the FDIC will have to use their credit lines or ask for more “one-time” special-fee contributions.

If the FDIC borrows money, and it is highly likely they will, they are going to have to raise the rates they charge member banks for the government backing. And to pay back \$3-400 billion? Rates will have to be raised quite high on the very banks struggling to raise capital and show a profit.

This is going to be a huge drain on the future profits of US banks for a long time. It is going to make it even harder for them to increase their capital—and they need to. But it has to be happy. Zombie banks, those that are bound to fail, need to be taken out and put into stronger hands to that credit growth can once again start to rise. But this will not happen overnight. It is going to take time.

This is a problem all over the developed world. Banks that have to raise capital and reduce loans are not growing credit and are a drag on growth. As credit shrinks, it is a large deflationary force. And that doesn’t take into account the implosion of the shadow banking system.

We are seeing statistical growth in the economy this quarter and probably the next. But unemployment is rising and wages and incomes are falling. We are in for a very poor, jobless recovery, and the risk of falling into a double-dip recession is quite high.

Courtesy of: John Mauldin’s “The Hole in the FDIC”
www.frontlinethoughts.com/learnmore

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to get the sale by themselves. As a result, in some markets, as many as a third of the sales can occur outside the MLS. Your job is to find them. And to do that, you can comb the land records at the local courthouse.

Remember, you are not looking for sales only in the same neighborhood. You’ll want two, maybe three of the same style, size and features. Also, sales should be no more than 6 months old, and the more recent the better.

If the search bears no fruit, turn your attention to the comps cited by the appraiser. Sometimes they are not all that comparable.

There are times when the appraiser’s knowledge of the comps is based entirely on the description in the MLS or the public records. Often, these narratives are far from accurate. Sometimes, they’re incomplete.

Worse, if the comps are short sales or foreclosures, as they frequently are in today’s mortgage meltdown marketplace, they may be the result of offers accepted based on BPOs or appraisals that were not that accurate either. In these cases, the person or persons making the decision to accept the offer may not have first hand knowledge of actual condition of the property or the values in the area as they relate to that spe-

cific asset. So, the sales data may not be an accurate reflection of the value of the asset sold at least in some cases.

The trick is to find as many differences as possible in your favor, differences the appraiser might not have known about, or did not have enough information to consider. One often-overlooked item is the age of the comparable house. Another is the size of the lot and a third is the room size.

Of course this kind of detective work requires that you have a way to get accurate information and that you have both time and a sharp eye for detail. It also helps if you have someone in the area who is willing to snoop around for you. But if you tell the appraiser your purpose and you come off as sincere, they should be willing to help you.

Most appraisers are aware enough of their shortcomings so that if your sleuthing turns up major differences, they would be willing to re-evaluate their original valuation.

Sources include:
Housing Scene, LA Times; Global Relocation Prime Times;
Wayne Marr, Economist; Present Value Appraisal Company;
USPAP; ReallEstateRama; Alternative Theories of Appraisal Bias
by Yiu, Tang & Choi

Appraisal Values Lag in Moving Markets

The decline in home prices in some areas is staggering. In this kind of market, appraisal values can lag materially behind analytical measures of the discounted present values. As the market decline steepens, property values actually fall below appraisal values due to data lag. Appraisals up to six months backwards looking through the use of recent comparable property transactions.

The definition of a property's value in practical terms is what a ready, willing and able buyer will pay for it. Values are rising and falling on a monthly basis right now. This is particularly challenging when ordering an appraisal as appraisers are bound to follow USPAP standards when completing their appraisals. This is why appraisals, based on sales from the previous six months, and appraisers as a result, generally lag behind a moving market whether it is going up or down.

Unfortunately, there is no set-in-stone definition for what is or is not a declining market. Either the pricing of comparables has fallen considerably, or the days on the market is over 6 months time.

Appraising is an art, not an exact science despite the many rules and parameters that USPAP rules place on the process. Those who practice it hold the fate of sellers, buyers and refinancers in their hands. Appraisers are fallible and if you believe you have an appraisal that is not in range, you can appeal the finding.

Appraisal management companies that hand out the assignments as a third party do much to protect the appraisers from pressure to steer the value one way or another. This practice does stop most schemes to compel appraisers to bump their findings.

At the same time, many Sellers contend that that the use of "middlemen" has created all sorts of challenges including the possibility that work can be assigned to inexperienced appraisers who may be out of area in relationship to the property they are being hired to appraise. Some geographic areas are so specialized, such as some areas of Washington DC, rent controlled areas and particularly unique vacation or seasonal areas that even an appraiser located close to the property may not be familiar with the nuances involved in appraising the property accurately.

To appeal an appraisal, start by looking to see if you have a full blown appraisal where the appraiser went to the property and was able to get inside. If the appraiser could not get

inside, there is much left to chance and speculation as the inside of the property could affect the actual value tremendously one way or the other, and the appraiser has been left to "guess".

More and more AVMs are being used to for both speed and cost issues. These less than accurate as they most commonly do not involve a trip to the property, much less allow access to the inside and are based primarily on available area data. If the property is unique, rural or in an area where a lot of data is electronically unavailable, such as many areas along the east coast, an AVM can be little more than a shot in the dark.

If a real live licensed appraiser did your appraisal and gained access to the inside and you believe the value is off, it can become a little more problematic simply because you are now going to have to deal with a human being who has feelings. So keep in mind you need to do everything you can to encourage the appraiser to make the choice to help you out. In their mind, their job is likely finished and getting an update out of them means they have to spend more time to help you out.

Suggest, firmly but very nicely, that the appraiser hired by the management company (or?) may have been unaware of some information you'd like to make available to them, and would they please take a second look.

Of course you can always ask for a second opinion from another appraiser although that can cost you an additional fee. Ask for a "review appraisal" to see if there is a cost savings to review the one you have rather than ordering a new one. To stand any chance of winning your point, the second valuation must be more than 5% different than the first. In the appraisal game, anything less than that is considered an acceptable difference.

You can grease the wheel further by doing some of the work on your own. It takes time and effort, but can pay off. To determine a fair-market value, appraisers look for recent sales of several comparable properties. Normally, they limit their search for "comps" to the local Multiple Listing Service (MLS). Sometimes there are comparables that are not reported on the MLS. Independent brokers who are not members of the MLS account for some sales, and others are made without the help of an agent. Then too, some MLS members don't put all their listings into the system, preferring to try

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