

June 2010

Optimism rising, but challenges remain

Results of the third-quarter installment of Grant Thornton LLP's *17th Bank Executive Survey*, conducted in association with *Bank Director* magazine.

Each quarter, Grant Thornton LLP, in conjunction with *Bank Director* magazine, conducts a survey for bank executives that helps gauge their opinions on the top concerns for the months ahead. In this third quarter 2010 survey, we analyzed bank executives' economic outlook and its impact on their operations and resources, their institutions' portfolio performance expectations, and growth options for 2010.

Economic outlook

While a sense of grim determination aptly described most bank executives' outlook for the banking industry earlier this year, optimism is on the rise, according to the most recent quarterly research for the *17th Bank Executive Survey*.

Indeed, it appears bank executives surveyed believe the tide has turned and things are looking up as 45% say they believe the U.S. economy will improve within the next six months (Figure 1). This demonstrates a significant increase from the 24% who were felt optimistic in the first quarter 2010 survey. While the bulk of respondents (44%) still believe the economy will likely remain the same over the near term, there was a drop by nearly half among those who believe that harder times are still ahead (11%, compared with 20% six months earlier).

When these results are evaluated according to institution size, there is a slight increase in the number of executives from larger institutions who see brighter skies ahead (48% of large institution bankers compared with 43% of those from smaller institutions). Regionally, bankers in the Southeast were the most optimistic (54%). Those hailing from publicly owned companies (53%) outnumbered bankers from private banks (38%) or mutual companies (46%) in terms of optimism. Finally, we also examined results according to regulatory structure, and those executives who come from FDIC-regulated banks were far more optimistic (51%) than those regulated by the Federal Reserve (41%), the OTS (38%), or the OCC (36%).

Turning attention to the outlook for the local economy, a similar uptick in optimism was found. Thirty-five percent of all bank executives surveyed (compared with just 22% in the first quarter) believe their local economy is poised to improve, and only 9%

(compared with 18%) believe things will get worse within the next six months.

This optimism translates to hiring: The vast majority of bank executives are not planning to decrease their workforce numbers in the next six months. Fully 59% say they will keep the number of employees the same and 25% say they will increase their workforce (Figure 2). Only 16% responded that they expect to decrease the number of bank employees by year end. However, 38% of those surveyed say they consider the retention of quality talent to be a top concern over the next 12 months.

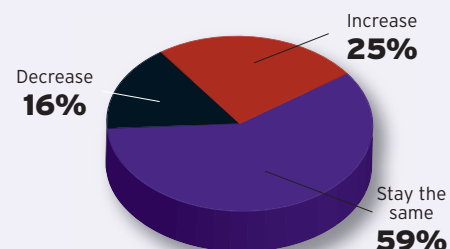
Figure 1

What is your outlook for the economy in the next six months?



Figure 2

Expectations for hiring



Lending and real estate concerns

The impact that the declining real estate market has had on the industry cannot be overstated given the precipitous drop in market values during the last two years. Although many predicted a bottom long before now, the market has remained weak well into midyear 2010.

To get a better sense of banker's perceptions of the current state of the recession in their regions, we posed the following question: "When do you think commercial real estate values in your local market will bottom out?" The largest percentage of bank executives surveyed (35%) believe values on commercial real estate will bottom out sometime within the next 12 months, but another 25% believe commercial real estate values already have bottomed out (Figure 3). Yet another 24% believe it will happen in the next six months. Not surprisingly, perspectives on this question have a lot to do with the respondent's region. Forty-two percent of bank executives from the Central region of the country think their values have already hit bottom, compared with only 10% of bankers in the Southern region and 18% of those in the Western region who think so.

Overall, bank executives are very concerned about exposure to commercial real estate losses over the next 12 months (58% noted it as a major concern), compared with exposure from losses in other areas of the portfolio (Figure 4). Similarly, losses from commercial loans garnered the next highest percentage (36%) of responses. Nearly 28% of bank executives named losses from residential real estate a major concern, and only 11% were concerned about consumer loan loss exposure.

Among the worries that bank executives have over the next 12 months, regulatory concerns overwhelmingly stand out above the rest. Fully 87% of bank executives ranked regulatory burden as a major concern over the next 12 months — nearly 30 points higher than the next pressing concern: exposure to commercial real estate losses (58% ranked it as a major concern). In a distant third place was a concern over retaining quality talent (37% ranked as a major concern.)

When analyzed from a regional perspective, a greater percentage of bank executives from the Southeast region charted major levels of concern about exposure to loan losses in all four lending categories. No significant differences were noted among large and small institutions, although bank executives from larger banks and those from privately held institutions were slightly more concerned about commercial real estate loan loss exposure.

Figure 3

When will we see bottom with regard to commercial real estate values?

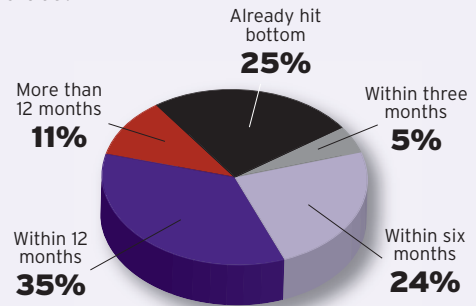
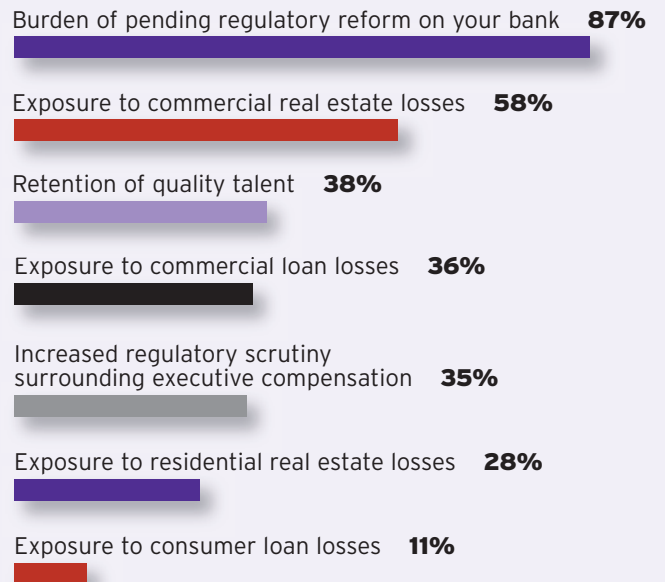


Figure 4

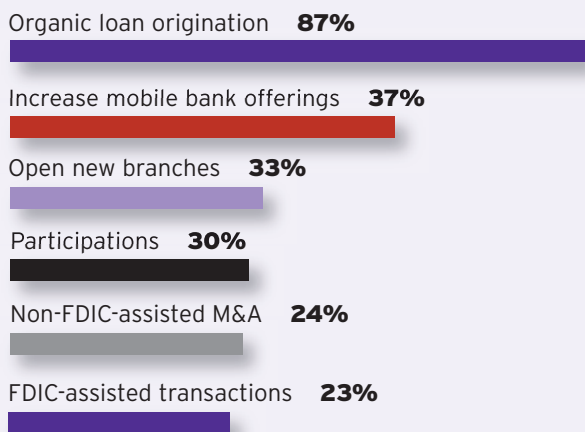
What is your biggest concern?



To address existing troubled loan situations, bankers are mostly turning inward to use resources they currently have on board. Seventy-one percent of bank executives report they primarily work out troubled loans, foreclosures and other nonperforming assets with in-house resources. Another 18% use both in-house and outside consultants. Less than 1% hire outside consultants exclusively as their primary means for assisting with this area. Nine percent of those surveyed say they have not had enough troubled loans to warrant the need for assistance at this time.

Figure 5

Top five anticipated means for growth



Growth options and capital

Looking ahead strategically, the survey sought to determine what bank executives see as growth opportunities for their institutions over the next 12 months.

Overwhelmingly, the greatest majority of respondents (87%) said they expected to grow their bank using organic loan origination. Other significant responses included increasing mobile banking offerings (37%); opening new branches (33%); loan participations (30%); and both non-FDIC-assisted acquisitions (24%) and FDIC-assisted transactions (23%).

When looking at the differences between large and small bank growth plans, large institutions appear to have greater expectations for organic loan origination (95% compared to 82% at small institutions), increasing mobile bank offerings (46% compared to 31%), FDIC-assisted transactions (28% compared to 19%), and non-FDIC-assisted transactions (30% compared to 21%). In addition, publicly owned banks (92%) and mutuals (89%) had somewhat greater expectations to grow through organic loan origination compared with privately owned banks (82%). Public institutions also responded with higher expectations (37%) for growth through non-FDIC-assisted transactions compared with private banks (21%) or mutuals (3%).

A regional breakdown of growth options reveals that banks in the Northeast (95%) and in the West (89%) showed the highest hopes for growth through organic loan origination. At 55%, banks in the Northeast had the highest percentage among all regions for anticipated growth through the use of participations.

Western bankers had significantly higher responses for growth expected via transactions — both FDIC-assisted (54%) and non-FDIC-assisted (36%). The Northeast region (46%) and the Central region (46%) showed the largest responses for increasing growth with increased mobile offerings. And the Northeast again outshone other regions with regard to plans to open new branches for future growth (56%).

Finally, with the regulatory scrutiny placed on capital standards in the wake of the financial crisis, the survey queried bank executives about their anticipated plans with regard to raising capital in the next 12 months. Less than a quarter of the total surveyed (22%) say it is very likely they'll go to the market to raise capital, but a higher percentage of those from the still-troubled Southeast (37%) say they'll do so. The majority (67%) say such action is not likely in the next 12 months. Finally, a small group (11%) said they had already successfully undergone a capital raise.

Conclusion

Bank executives are planning for growth in the year ahead using traditional means of loan origination and keeping their options open with regard to acquisition opportunities. Many are bracing for more bumps ahead in the commercial real estate market as it will likely experience declines for the near future. However, a sense of optimism is in the air as the majority of bank executives believe the light at the end of the tunnel is in sight for the industry at large.



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