Spotlight: Community Banking

The Financial Accounting and Standards Board (FASB) sets the tone for accounting practices across a wide array of businesses, including the banking sector. Prior to the 2007-2009 Recession, the FASB adopted rule modifications, known as FAS157 that changed the way businesses were supposed to value assets. The intent of the rule change, from an accounting standpoint, was to make business operations more transparent. During the US housing market collapse and subsequent financial turmoil, Georgia became home to a disproportionately large number of both housing foreclosures and bank failures. The changes adopted by the FASB that took effect in November 2007 likely made community-based banks, especially those located in high-growth areas like Georgia, riskier, not safer.

The Vicious Cycle

The new standard expanded mark-to-market (MTM) valuation of assets held by banks. A major issue with MTM prices that has been identified in research is the potential for “negative feedback loops.” In a stable market, the impact of the accounting rule change may have been beneficial to the investor and for banks; however, the timing was unfortunate. The rule changes were made just prior to the onset of the US housing market collapse. The result was a vicious cycle of negative revaluation, forced fire sales of bank assets, followed by more negative asset re-valuations with the (then current) market prices based on the new fire-sale prices. Commercial builders’ loans and mortgage-backed securities were extreme examples of this cycle. The MTM value of these “assets” fell to pennies on the dollar, and in some cases, essentially zero, driving a wedge between the value based on its cash flow and the current market price.

This cycle was especially vicious for smaller banks that, because of their ties to the local housing market and commercial real estate sector, were less able to diversify their asset portfolio. As assets held by community banks lost value, so did the stock price of many of even the strongest publically-traded community-based banks. While federal officials struggled to formulate a strategy to deal with these problems for the nation’s largest banks, community-based banks were already starting to fail. Banks in fast growing states were especially vulnerable. Having contained some of the nation’s fastest growing counties at that time, Georgia became an epicenter of foreclosures and of bank failures.

The graph (page 4) depicts an index of 134 publicly-traded community-based banks along with delinquency rates for all loans (in red) and residential properties (in green). In the 3rd quarter of 2006, the US started experiencing a rise in the rate of foreclosure in residential property. In January 2007, the average value of stock in these 134 banks began to decline rapidly. The decline in these banks’ average stock price is likely the result of investors pricing in the risk associated with these banks’ exposure.

(Continued on page 4)
For the region, the number of people filing initial claims for unemployment insurance on a year-over-year basis declined by 8.1% in February. Though initial unemployment claims continue to trend downward for the region, the rate of decline continues to slow. In at least one county, Carroll, initial UI claims spiked upward at the first of the year, and in February 2013 it remained above the level experienced in the previous year. The largest declines in initial UI claims in both absolute (-122 claims) and percentage (-25.0%) terms came from Coweta. The region has yet to return to pre-recession levels of new UI claims, and at the current rate of decline, those levels are likely more than a year away. Furthermore, seasonal layoffs have increased substantially since the beginning of the recession and show no signs of retreating to prior levels.

The unemployment rate in the West Georgia Region stands at 8.7% in February 2013, which is down from 9.1% in February 2012, and down half a percentage point from January 2013. Four counties in the region saw their unemployment rates shrink over the past year. Polk saw the largest decline of one full percentage point in its rate. Haralson had the next largest decline, dropping 0.8 percentage points off its unemployment rate, which represents a 8.2% reduction in its unemployment rate; however, Haralson experienced a slight decline in its labor force over the same period. Coweta reported the largest increase in its labor force, adding 1,210 new workers over the year. Carroll was the only county in the region to report a higher year-over-year unemployment rate, adding half a percentage point to its rate over the year. Despite a larger seasonal lay-offs, in total the region added 3,705 positions to the labor force over the year.

Total employment by sector in West Georgia continues to show modest signs of improvement. The most recent sectorial data indicate that five of the six counties in the region are now experiencing total employment growth. After several quarters decline, government employment has started to increase modestly in four West Georgia counties, with Carroll experiencing the largest government employment growth of 7.6%. The largest employment gain in both percentage and absolute terms came from the service providing sector. With the exception of Polk, every other county in the region experienced service employment growth above the average reported by the state. Haralson saw the largest increase of 7.9% between 2011:Q3 and 2012:Q3, followed closely by Carroll. Goods producing jobs have been a recent source of job growth for the region; however, the most recent data indicate that sector’s momentum is slowing. Three of the six West Georgia counties have seen goods producing jobs decline between 2011:Q3 and 2012:Q3. Haralson experienced the largest year-over-year increase of 9.0%.
Foreclosure rates have fallen by 47.8% across the West Georgia Region over the past year. As of February, the region reported 559 houses in some stage of foreclosure, as opposed to 1,071 a year earlier. Every county in the region has experienced year-over-year and month-over-month reductions in the number of foreclosures. Since February 2012, Carroll County has seen the largest percentage decline at −56.4%. Although Douglas continues to post the largest absolute number of foreclosures in the region (186), it also has seen a large decline, both in absolute and percentage terms. The smallest decline came from Coweta (-35.8%); however, Coweta’s foreclosure rate has remained low, as compared with the remainder of the region, throughout the recession and into the recovery. Although the region has experienced improvements over the past year, currently every county except Haralson has a foreclosure rate higher than the state average, with Douglas County posting the highest rate in Georgia.

The declining number of foreclosures in the West Georgia housing market has led to an upward trend in the average sale price of housing in most counties in the region. Since February of 2012, every county in the region except Polk has experienced increases in housing prices. In Carroll County, the average price for existing single family housing fell to a recent low of $63,800 in February 2012, but has since steadily risen to $97,700 in February 2013, an increase of 53.1%. In November 2011, the average sale price in Douglas reached a bottom of $76,300. Between February 2012 and 2013, prices in Douglas have risen by an average of $25,000 (or 32%). Paulding saw its housing prices reach a bottom in May 2011 ($84,000), however, over the past year Paulding’s prices have risen by about $23,500 (or 27.9%). Haralson experienced the largest increase in sale price over the past year (86.9%), however, the volume of sales in Haralson has remained relatively small. Though Coweta experienced smaller year-over-year increases in sales price, its prices have trended upwards since the beginning of 2011.
sure to the housing market and assets backed by real estate. The decline in these banking stocks continued for more than two full years, extending from January 2007 to March 2009, falling from a peak of 1.19 to a minimum of 0.36 (a decline in value of 69.8%).

In March 2009, the FASB initiated discussions about relaxing the MTM rules to help lessen the severity of the vicious cycle (denoted in the graph by the light blue vertical bar). Two weeks later, the FASB issued the official amendment that provided more guidance on valuing assets and securities in illiquid markets. The amendment states that if the market for a security is illiquid, and/or a sale, hypothetical or not, was not orderly (i.e., forced) then management is allowed to use different "techniques" to value those securities, such as discounting cash flows. Early adopters were allowed to apply the ruling as of March 15, 2009, and the rest as of June 15, 2009. Interestingly, the period surrounding the March-April 2009 discussion period and rule change marks the end of the rapid decline in these 134 community bank stocks. One might argue that these banking stocks stabilized as the mortgage delinquency rates began to subside; however, delinquency rates continued to rise for another year beyond the rule change.

Another explanation is that allowing banks to use more appropriate valuation methods for illiquid assets helped stabilize investors’ risk assessment of the community banking sector. Investors, who keenly understand accounting rules, stopped bidding down community bank stock prices once these banks were allowed to be less aggressive in re-valuing their assets.

Consequences of Georgia Bank Failures
Since 2000, Georgia has seen 86 of its banks fall into receivership, and as of January 2013, Georgia accounts for 17.4 percent of closed banks in the US. From peak to trough employment (2006 to 2010), banking-related firms in Georgia lost about 16,000 jobs. Though the recovery has brought some of those jobs back to the state, the loss in labor income from these banking jobs accounts for $1-$1.2 billion per year, and the total estimated economic output loss for the state over that period amounts to an estimated $7.0 billion.

Update (continued from page 1)

has seen the greatest improvement with the number of unemployment claims 25% lower in February 2013 compared to February 2012. On the other hand, claims rose by 24.2% over the same period in Carroll County.

The most recently available employment data show job gains in five of six counties in the region. As summarized in the table on page 2, total employment rose in the West Georgia region by 2.91% between 2011Q3 and 2012Q3. Only Polk County sustained net job losses over this one year period (down .6%). The region is experiencing sharp growth in health care, accommodations/food services, and temporary employment with only modest gains in government and retail employment. Year-over-year health care related employment rose by 6.4% between 2011Q3 and 2012Q3. Manufacturing employment was flat over this same period. Recent housing data show an uptick in the housing market with single family permit activity in the West Georgia Region up by 13% in the first two months of 2013 compared to the same period in 2012.

The West Georgia region has had a number of positive developments on the economic front over the past few months. In Carrollton, Decostar plans to add 120 jobs as part of its $26 million auto parts plant expansion. Printpack (Villa Rica) is undergoing a $66 million expansion of its packaging facility, adding about 20 new jobs. Honda Precision Parts in Tallapoosa reported record production levels in 2012 and recently added over 75 jobs. Alpharetta-based AGC Glass Company completed a lease on a 225,000 square ft. building in Lithia Springs. The new plant is projected to add 150 jobs over the next several years. In health care, a new Polk Medical Center has been approved for a location between Cedartown and Rockmart. This 75,000 square foot hospital is expected to open in mid-2014. Tanner Hospital also opened its new emergency department and surgical services unit in Carrollton in January. In early 2013, the University of West Georgia (UWG) agreed to acquire the Newnan Hospital which will be renovated to support UWG’s expanding health care presence in Coweta County. In January, Georgia Power announced the planned shutdown of five coal-fired generators at the Plant Yates electricity plant in Coweta County. The two remaining units will be converted to natural gas. The modification and curtailing of operations, expected to be completed by April 2015, will result in the loss of approximately 300 employees.