The State of Banking in Arkansas

Prepared for the Arkansas State Economic Forecast Conference

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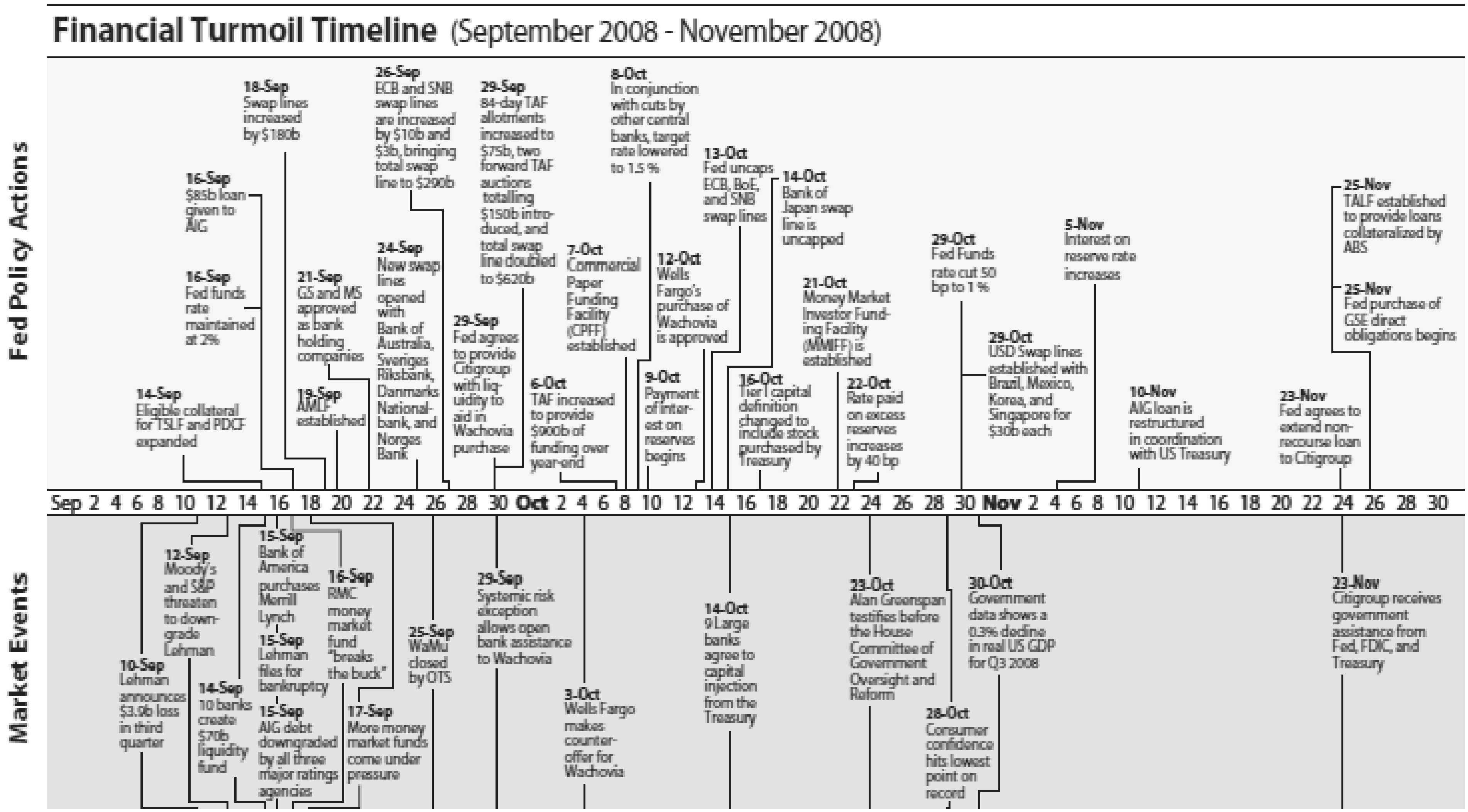
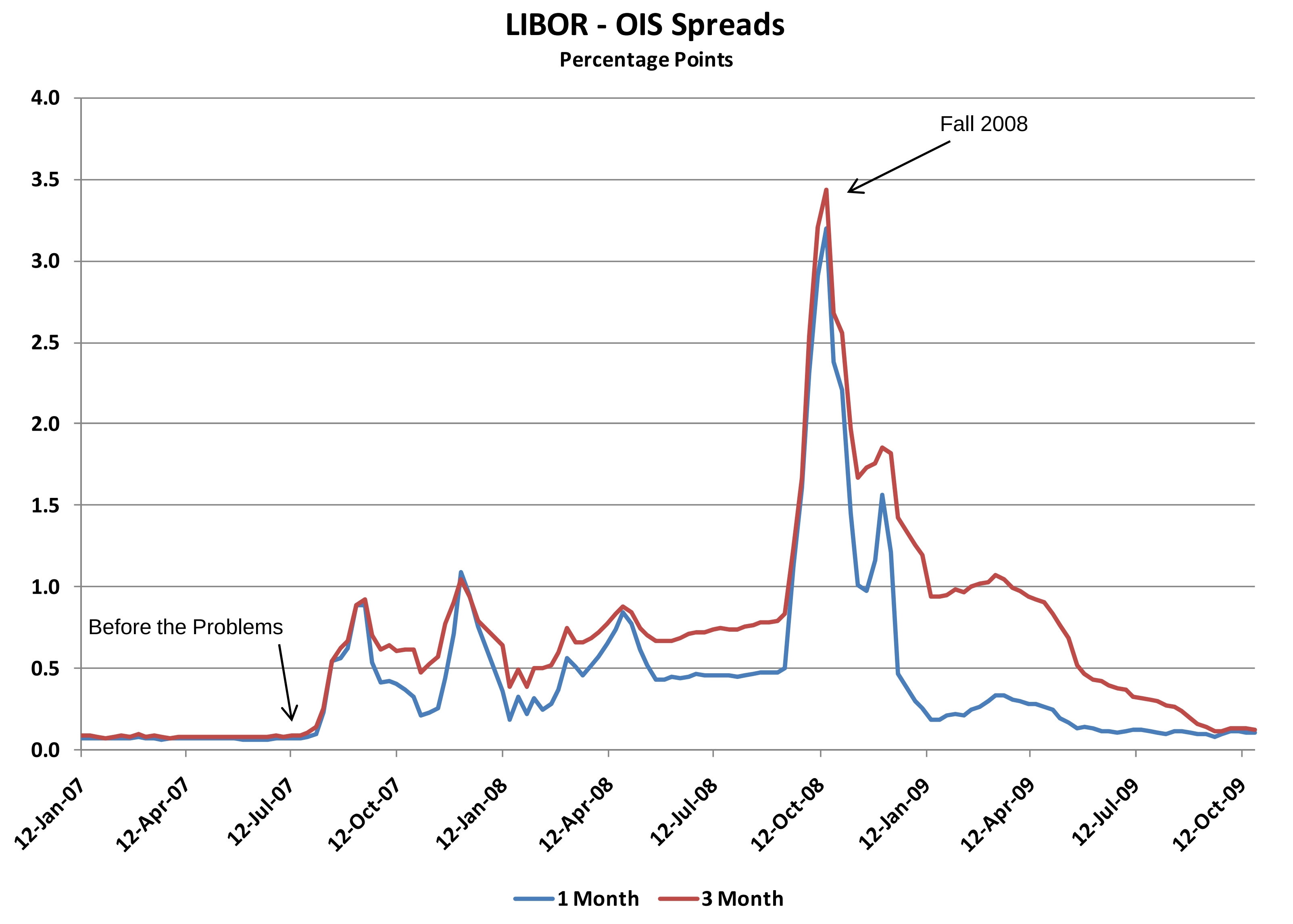
Just over a year ago...



Source: Reuters.com

The country faced a financial crisis.



The Federal Reserve, the U.S. Government, and the Federal Deposit Insurance Corporation all responded.

"First Responders" to the financial crisis

Federal Reserve

- Provided funds (liquidity) to stabilize financial markets

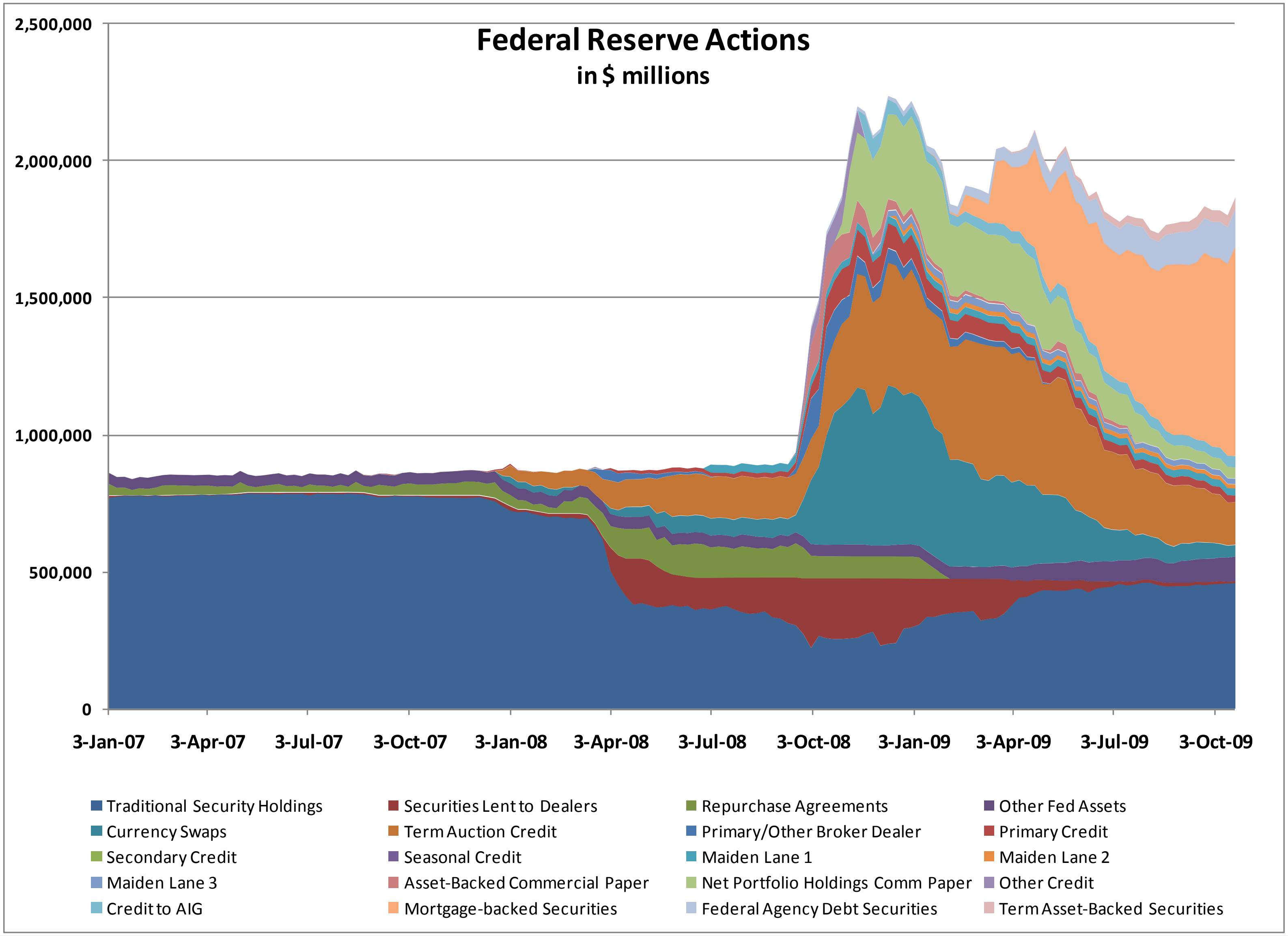
United States Government

- Funded the Troubled Asset Relief Program and the $800 billion economic stimulus

Federal Deposit Insurance Corporation

- Raised bank deposit insurance limits and provided other bank debt guarantees

A picture of the Fed's actions.



Congress responded with the Troubled Asset Relief Program.

Utilization of TARP Funds	October 7, 2009
Capital Purchase Program (CPP) - $204.6 billion less $70.7 billion repaid (690 institutions initially; now 650 institutions)	$133.9 billion
Capital Assistance Program (CAP)	$0
Consumer and Business Lending Initiative (Super TALF)	$20 billion in LLC
Public-Private Investment Program (P-PIP) – Legacy Assets	$16.7 billion
Targeted Investment Program (TIP) – Citi, BoA	$40 billion
Asset Guarantee Program - Citi	$5 billion
Auto Industry/Auto Supplier Program – GM, GMAC, and Chrysler	$83.5 billion invested $2.1 billion repaid
Systemically Significant Failing Institutions - AIG	$69.8 billion
Affordable Housing Support and Foreclosure Prevention (Making Homes Affordable Program)	64 servicers; incentive caps of $27.2 billion

Source: www.financialstability.gov

The Federal Deposit Insurance Corporation responded with higher levels of insurance.

Federal Deposit Insurance coverage increased to $250,000 per owner through December 31, 2013 (Beginning May 2008)

Banks also had the option to pay a fee to participate in two other temporary programs beginning November 2008:

- Full insurance of noninterest demand accounts in excess of $250,000
- Guarantee of certain newly-issued senior unsecured debt of banking organizations

Separate from the FDIC program, the Treasury temporarily guaranteed participating money market mutual funds until September 19, 2009

The financial crisis and recession spilled over into the banking system.

	Return on Assets		Non Performing Loans/Total Loans		Loan Loss Reserve/Non Performing Loans		Tier 1 Leverage Ratio		CRE / Total Loans	
	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008
Banks/thrifts > $100 billion	0.26	0.22	4.85	3.12	66.64	80.31	7.35	6.5	12.06	11.78
Banks/thrifts $15 - $100 billion	-0.18	-0.61	4.01	2.86	76.75	79.91	9.67	8.06	15.6	16.42
Banks/thrifts $1 - $15 billion	-0.8	-0.33	4.44	3.07	47.64	59.31	8.54	8.72	33.05	33.28
Banks/thrifts < $1 billion	-0.05	0.12	3.32	2.45	47.99	58.3	9.68	9.85	31.97	32.86

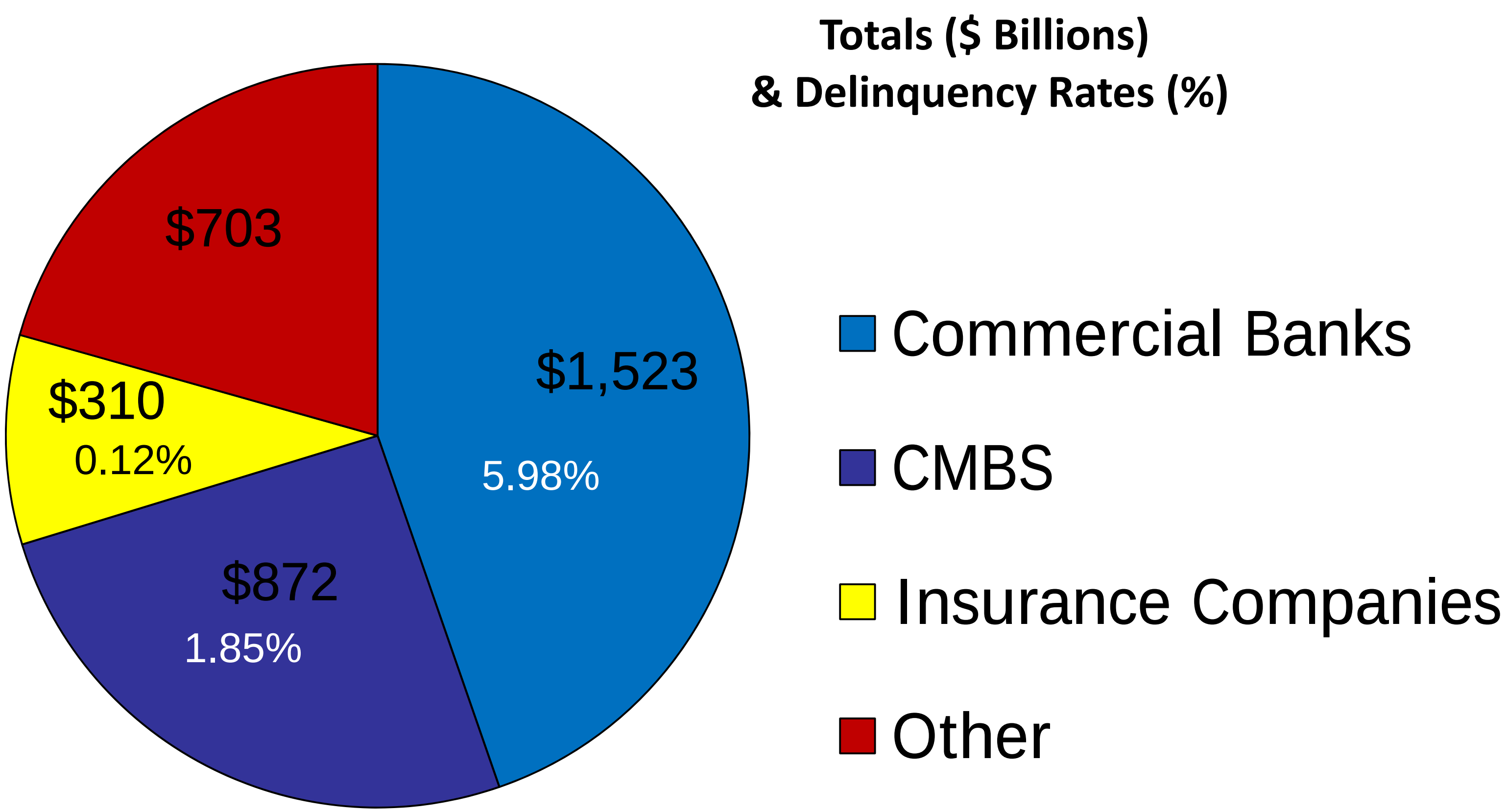
Source: Reports of Condition and Income

Banks and thrifts in Arkansas have experienced some stress as well.

	Return on Assets		Non Performing Loans/Total Loans		Loan Loss Reserve/Non Performing Loans		Tier 1 Leverage Ratio		CRE / Total Loans	
	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008
Banks/thrifts $15 billion or less	-0.5	-0.15	3.99	2.82	47.76	58.95	9.0	9.19	32.62	33.1
Arkansas-HQ banks /thrifts $15 B or less	0.59	0.78	2.55	1.71	67.19	89.85	9.25	8.93	33.79	34.68
Fayetteville-headquartered banks/thrifts	0.5	0.66	3.15	2.41	55.55	67.72	7.92	8.04	33.42	33.38
Little Rock-headquartered banks/thrifts	0.11	0.65	3.32	1.64	67.69	108.65	10.0	9.5	44.34	43.7

Source: Reports of Condition and Income and OTS Reports

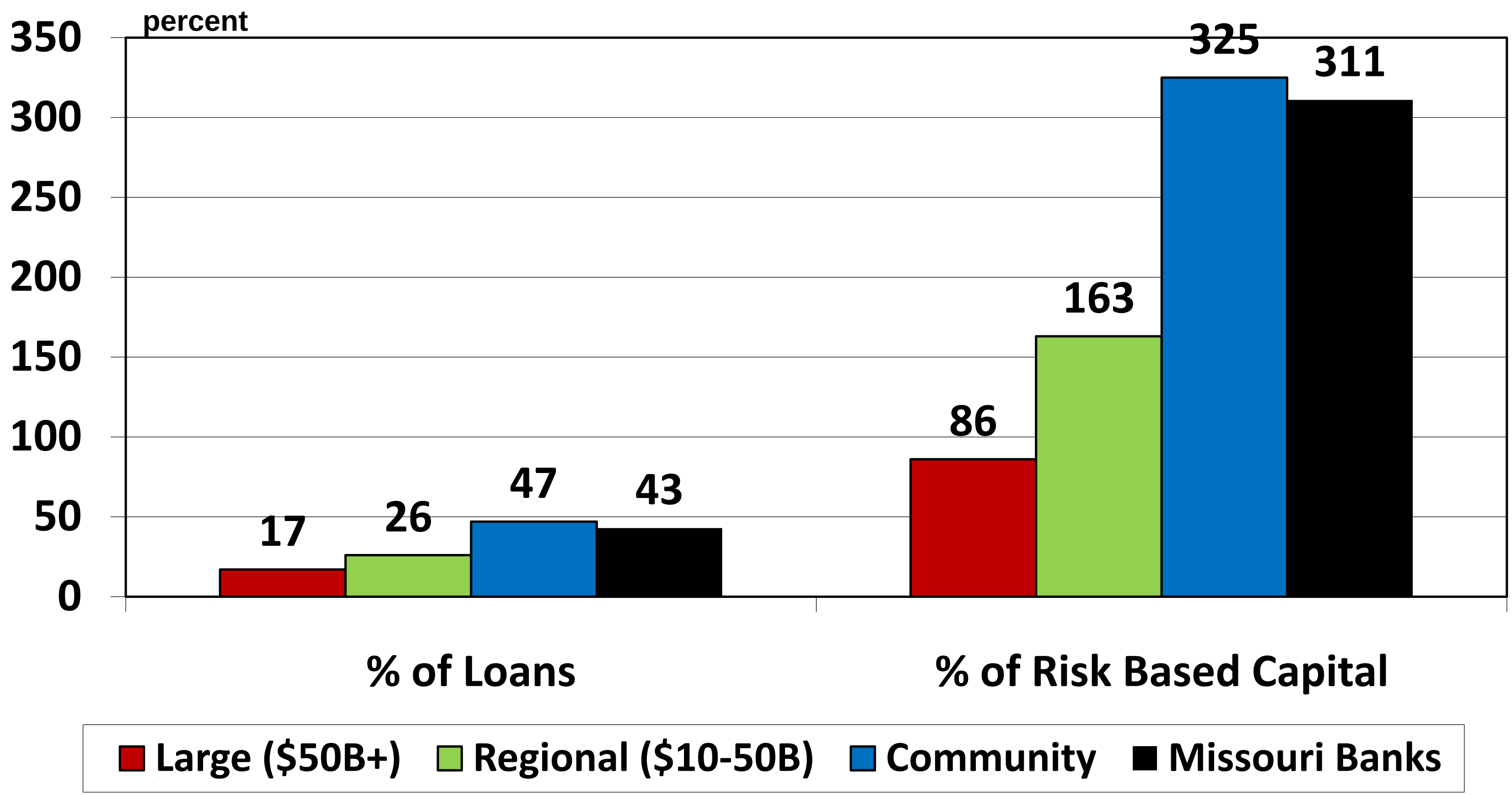
The driver has been commercial real estate (CRE). Banks have significant exposure to CRE.



Source: CMSA, Flow of Funds Accounts

1st & 2nd Quarter 2009

Relative to size, smaller community and regional banks are more exposed to commercial real estate.



Source: Reports of Condition and Income

2nd Quarter 2009

CRE risks are widespread.

June 30, 2009

Group/Asset Class	CRE Loans/Total Loans	Nonperforming CRE Loans/Total CRE Loans	CRE Net Charge-offs/CRE Loans
All US banks/thrifts < $15 billion	32.62	6.75	2.23
All Arkansas banks/thrifts < $15 billion	33.79	3.86	0.96
All US banks/thrifts < $1 billion	31.97	5.81	1.44
All Arkansas banks/thrifts < $1 billion	29.06	2.92	0.68

Source: Call Reports and OTS Reports

A look at Arkansas metro areas as compared to other regional MSAs.

June 30, 2009

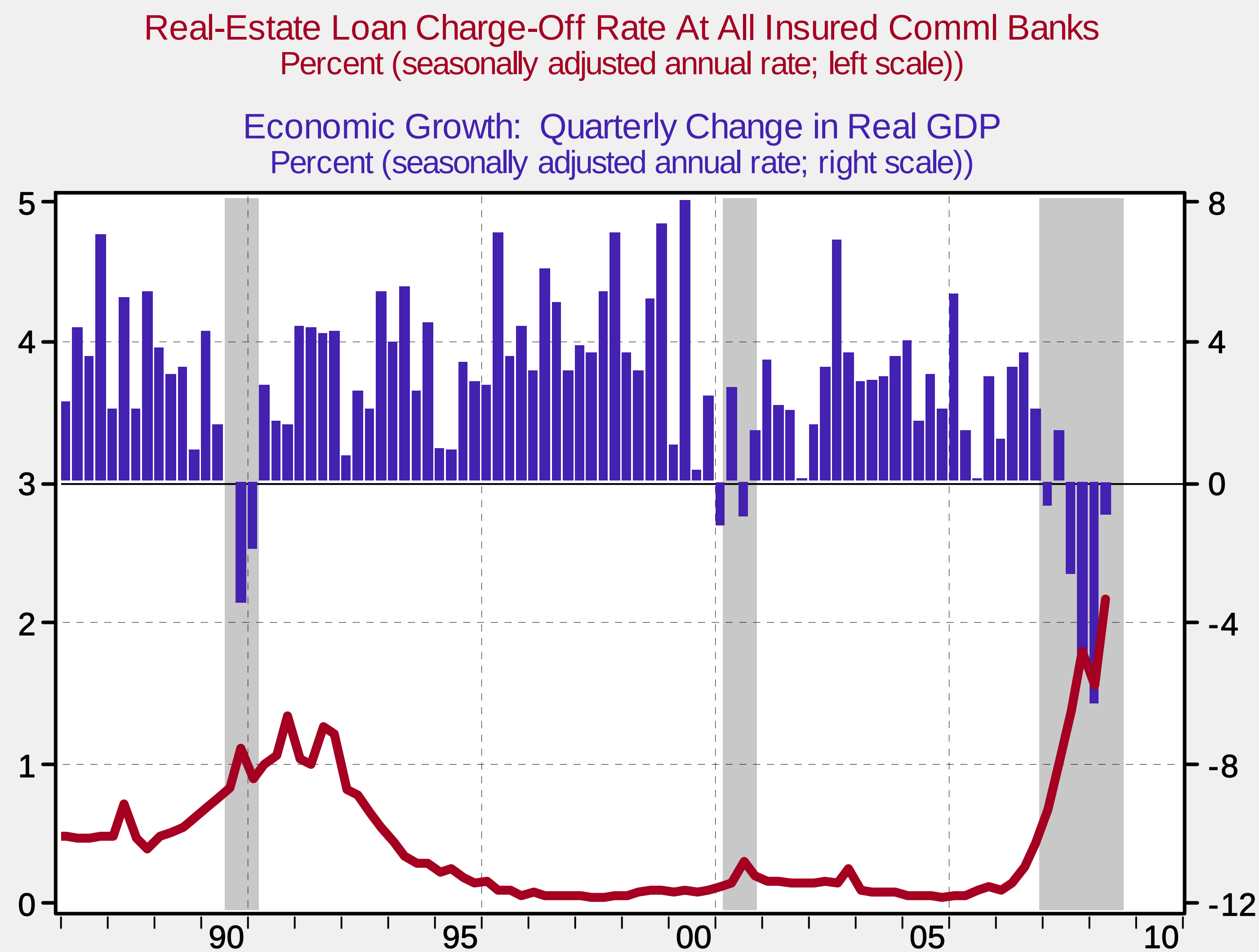
MSA	CRE Loans/Total Loans	Nonperforming CRE Loans/Total CRE Loans	CRE Net Charge-offs/CRE Loans
Fayetteville	33.42%	4.75%	0.53%
Little Rock	44.34%	5.06%	2.04%
Memphis	26.37%	5.75%	2.65%
Springfield, MO	33.07%	3.19%	1.17%
St. Louis	37.06%	5.76%	1.8%

Understanding the valuation problem.

Change in Cap Rate → Change in NOI ↓				Long-Term Average ↓	
	6.50%	**7.50%**	**8.50%**	**9.50%**	**10.50%**
Cash Flow Flat	1000	1000	1000	1000	1000
Value	15,384.62	13,333.33	11,764.71	10,526.32	9,523.81
Change in V from Baseline		-13.3%	-23.5%	-31.6%	-38.1%
Cash Flow Down 10%	900	900	900	900	900
Value	13,846.15	12,000.00	10,588.24	9,473.68	8,571.43
Change in V from Baseline	-10.0%	-22.0%	-31.2%	-38.4%	-44.3%
Cash Flow Down 20%	800	800	800	800	800
Value	12,307.69	10,666.67	9,411.76	8,421.05	7,619.05
Change in V from Baseline	-20.0%	-30.7%	-38.8%	-45.3%	-50.5%

Source: Blackrock and Atlanta FRB

Real estate loan write-offs tend to lag economic performance.

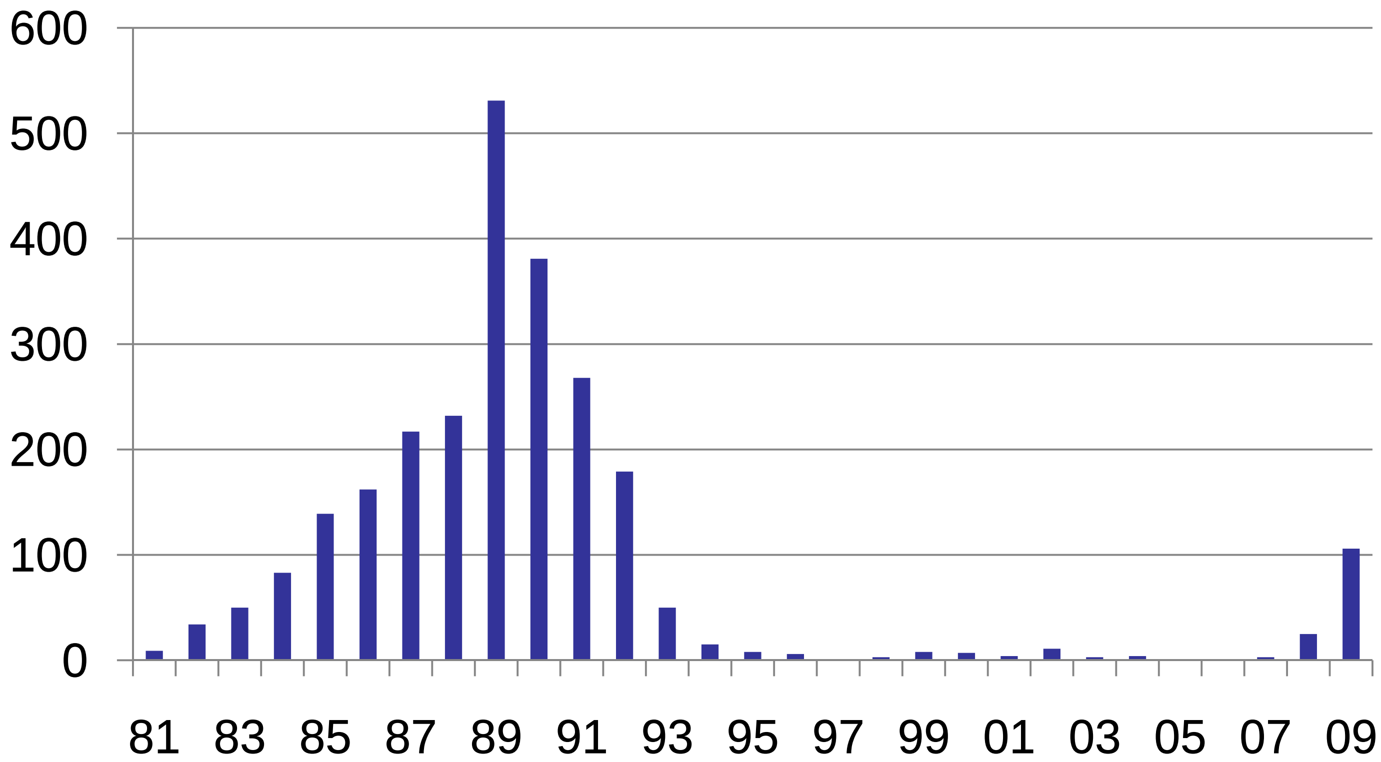


Periods of economic recession are denoted by vertical gray bars.

Sources: Federal Reserve Board and Bureau of Economic Analysis. Quarterly data through Q2.2009.

As write-offs have grown, so have bank failures.

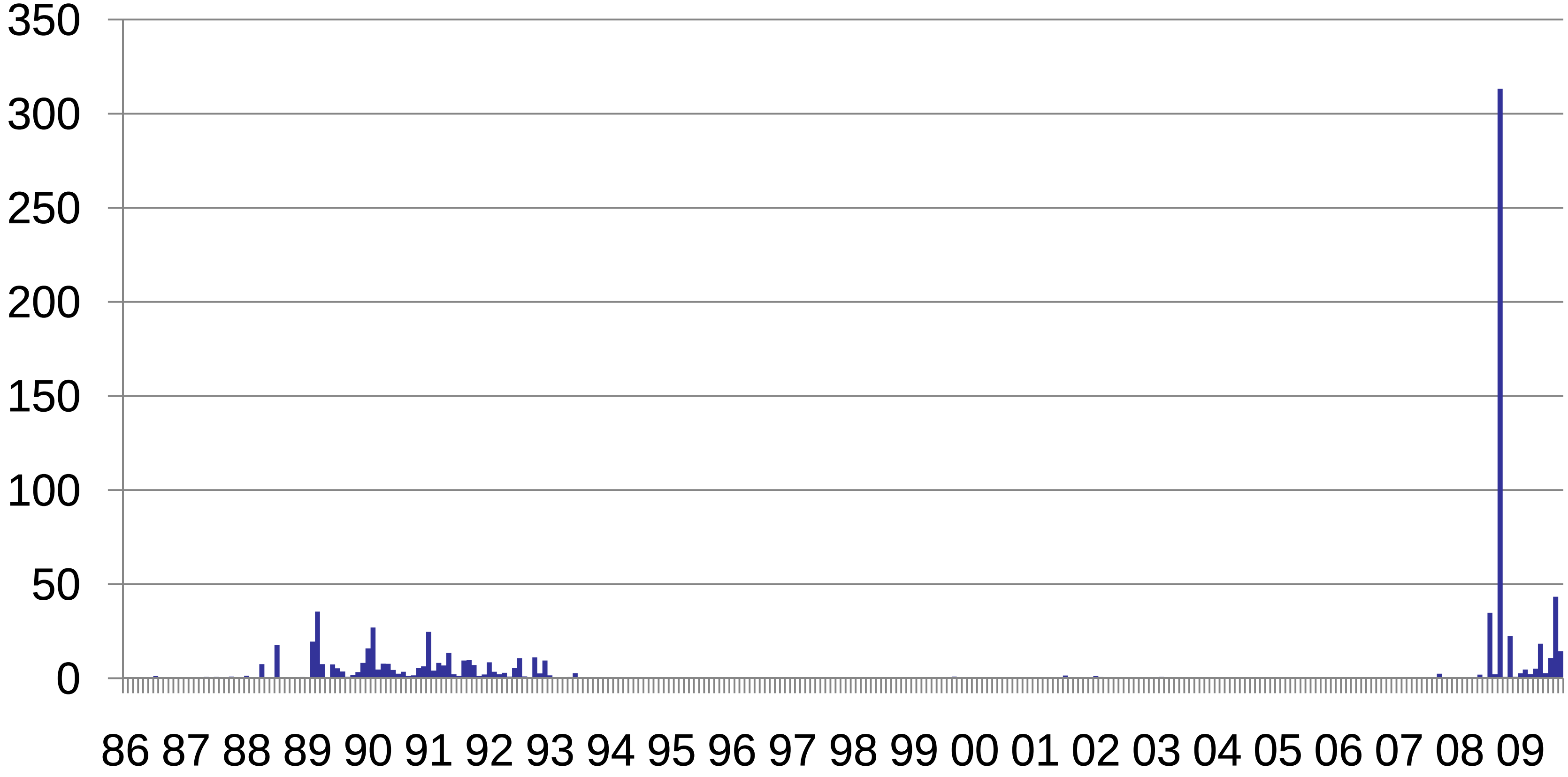
Total Number of Failed Banks and Thrifts



Source: FDIC; data as of 10/23/2009

When put into constant terms, it appears that assets of failed banks will exceed the 1980s.

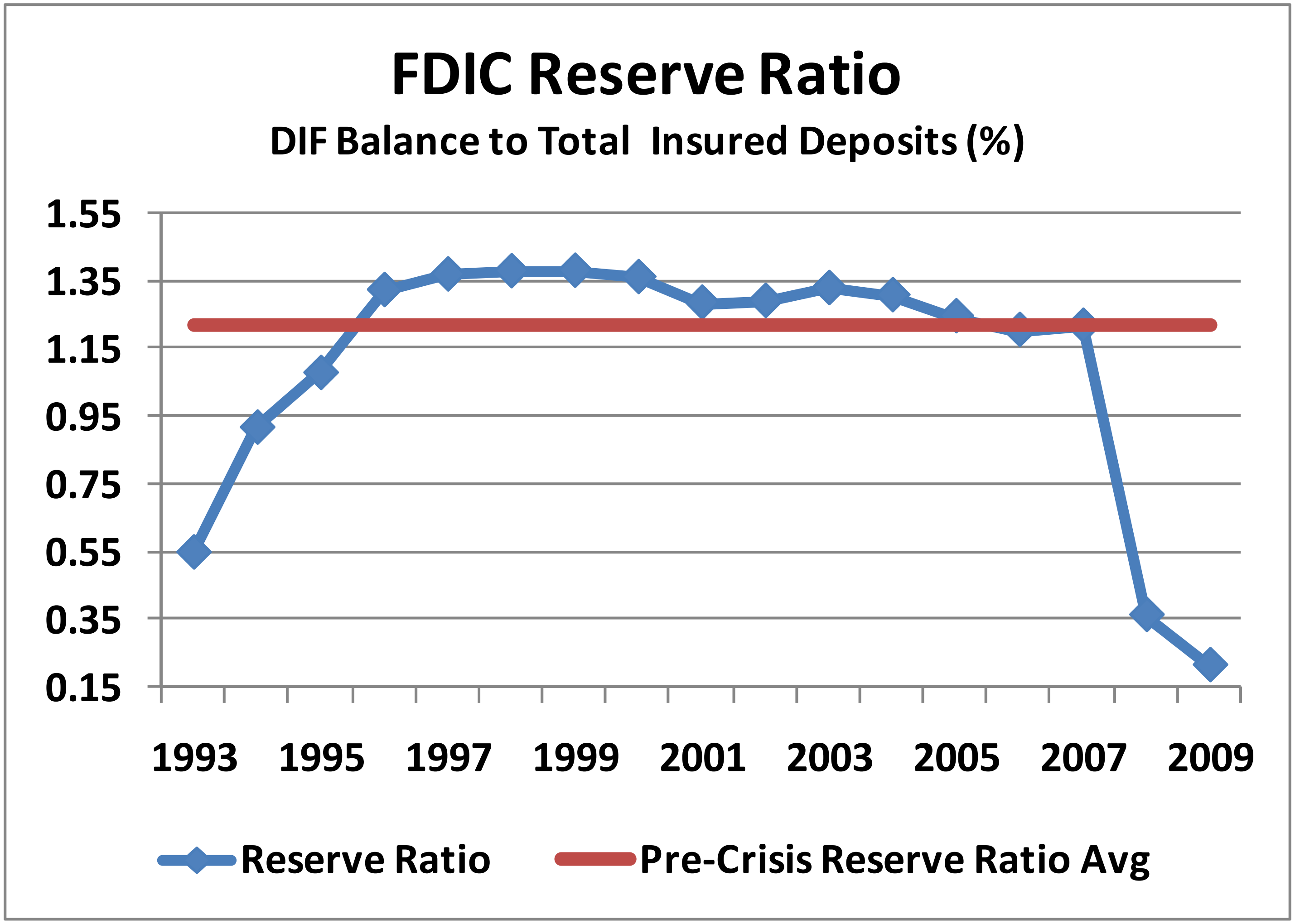
Failed Assets by Month in September 2009 Dollars



Yet, FDIC statistics tell only part of the story.

Institution	Qtr that distress/failure occurred	TA as of the quarter listed (in $ bln)
Bear Stearns	Q1 2008	398.9
AIG	Q3 2008	1022
Merrill Lynch	Q3 2008	875.8
Fannie Mae	Q3 2008	896.6
Wachovia	Q3 2008	764.4
Freddie Mac	Q3 2008	804.4
Lehman Brothers	Q3 2008	639.4
Citi	Q4 2008	1938
Bank of America	Q4 2008	1818
GMAC	Q4 2008	180
National City	Q4 2008	143.7

While the FDIC has accelerated the pace of resolutions, the insurance fund is under pressure.



In Conclusion

- Income producing property loans pose a considerable risk to banks as we move into 2010.
- Failures among commercial banks and thrifts will continue, even as the economy recovers. However, the resolution mechanism for community and regional banks is strong, although it is facing substantial strain.
- Banking organizations with strong capital and risk management practices will weather the storm and stand well-positioned for the future.

Questions?