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Banking by John Hoefle

FDIC reports record bank profits

The Federal Deposit Insurance Corp.'s banking statistics are a fantasy, designed to hide an awful truth.

Commercial banks in the U.S. earned a record $7.6 billion in profits during the first quarter of 1992, according to the Federal Deposit Insurance Corp.'s (FDIC) latest *Quarterly Banking Profile*.

Three major factors were cited by the FDIC for this belief-defying performance. First, the banks profited significantly from the drop in interest rates, by increasing the spread between what they earned on their assets and what they paid on their liabilities. Net interest income was $2.8 billion higher than the first quarter of 1991.

Second, the lower interest rates increased the banks' profits on sales of securities in their own investment portfolios. Gains from securities sales added $682 million to the year-to-year improvement in earnings.

Third, many of the banks cut back or eliminated their shareholders' dividends, and retained the money. Retained earnings contributed $4.7 billion of the $7.6 billion in ostensible profits.

While the banks booked profits on every transaction they could, they also systematically understated the losses on their loans, primarily on their real estate loans.

U.S. commercial banks had $854 billion in commercial real estate loans as of March 31, an increase of $3 billion over the end of 1991 and an increase of $16.5 billion over the first quarter of 1991. While banks would prefer to make no real estate loans at all, the loans have increased anyway, because the banks have chosen to roll over many unpayable loans rather than admit their losses.

Total loan loss reserves increased a mere $704 million during the first quarter, to $55.8 billion. From a year ago, the reserves have increased just $754 million.

Meanwhile, the banks' reported non-current loans and leases have dropped. Non-current loans and leases stood at $75.3 billion at the end of the quarter, $691 million less than the end of 1991, and $8 billion less than March 31, 1990.

In a period in which real estate developers and other businessmen have claimed it is almost impossible to get loans, in which personal and corporate bankruptcies are skyrocketing, and in which some of the biggest real estate companies in the world are collapsing, how is it possible that the level of non-performing loans is decreasing?

It isn't. The banks are cooking the books.

Let's take another look at the $854 billion in real estate loans. The banks' total real estate exposure is actually significantly greater, because of the use of real estate as collateral for other types of loans, but the $854 billion is more than enough to make the point.

The claimed $7.6 billion in profits is just under 0.9% of the total real estate loans, meaning that a drop in property values during the quarter of just 1% is enough to wipe out this alleged profit.

Over the past 12 months, the banks have reported $20.2 billion in profits. A 2.4% drop in real estate values is therefore sufficient to wipe out all the profits claimed by the bank in the past year.

A drop in real estate values of just 16% is enough to wipe out all the reported profits for the U.S. commercial banking system since 1984!

According to the FDIC, commercial real estate accounts for $372 billion (44%) of all the direct real estate loans made by banks. Of that amount, $20 billion has been classified as past due more than 90 days or on accrual, and another $4 billion is past due 30-89 days. Were the banks to write off just the $24 billion they admit is past due, that would wipe out virtually all the banks' reported profits since the end of 1990.

Commercial real estate values have dropped 50% or more in most major markets. For example, in New York City, Citicorp recently sold an office building previously valued at over $250 million, for $119 million, prompting the *Financial Post* of Toronto to comment that the sale "sliced the value of all Manhattan real estate in half." An Olympia & York office tower in Manhattan, which O&Y valued at $600 million, was recently valued at just $200 million.

A 50% drop in commercial real estate values means that the banks should write off half the value of their commercial real estate loans, or $186 billion. That step alone would wipe out 78% of the banks' claimed $239 billion in equity, leaving just $53 billion. That would drop the banks' claimed equity capital ratio from 6.96% to just 1.54%

These numbers may seem dramatic but, if anything, they understate the banks' actual losses. The real estate bubble has popped, and trillions of dollars of alleged value of U.S. real estate has evaporated. These dollars, which banks, companies, and individuals counted on their balance sheets as assets, are gone. That is what the bankers and the regulators are trying to hide with these ludicrous statistics.

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