Statement of Gary L. Fox, CPA, CFE

Before the

U.S. House Subcommittee in Financial Institutions and Consumer Credit

August 16, 2011

Chairman Capito and members of the committee, thank you for inviting me to participate in your hearing today. My name is Gary Fox and I was in the banking business in Georgia from January, 1981 until April 2011 when our bank was closed by the Georgia Department of Banking and Finance and sold with a loss share agreement to Hamilton State Bank. I started my career as a bank examiner with the State of Georgia and began working at the Bartow County Bank in May, 1983. I am also a Certified Public Accountant and am now in private practice.

I've divided my remarks into three categories. First, How We Got here to give you some historical perspective. Second, What Made It Worse where I'll mention issues such as appraisal policies, market disruptions caused by unprecedented government involvement, and the application of certain regulatory and accounting policies. And third I'll mention some real concerns I have with how loss-share is playing out in the market.

Included with my testimony are sides that I will be referring to that were furnished to me by John Hunt of Smart Numbers which would be a good resource for you going forward.

How we got here

I saw a lot of changes in our industry in 30 years and had the pleasure to meet and know a lot of great community bankers during that time. I have a depth of knowledge about the community banking industry in Georgia that few other people have.

The biggest change that I saw over the years (other than regulatory) was the ease of entry. When I first got into the business it was quite difficult to get a bank charter. In fact, it was quite a chore to even get a branch application approved. At that time you had to convince the chartering authority of convenience and need. Sometime in the mid 1990's that went out the window and it seemed to me the only requirement became whether or not you had enough initial capital to meet the chartering authority's requirement. As a result, we had an overabundance of banks. Many banks relied heavily on brokered deposits since there really wasn't a need for a bank in that particular community in the first place. It was also a reason why so many banks did Out of Market Lending and Participation Lending since there wasn't enough demand in the community they operated. On top of that, in 1996, Georgia passed statewide branching. Previously, Georgia had been a state that only allowed a bank to operate in the county where it was chartered in unless it formed a bank holding company and entered a new market by buying another bank in a whole bank transaction. So as a result many of the banks in markets that were not as robust branched into the metro Atlanta area to take advantage of metro Atlanta's growth. This only compounded the problem. After all, it only takes a couple of folks polluting the pool to ruin the swimming for everyone.

Another thing that got us here was prompt corrective action which was put into law in 1991 as a result of the S&L crisis. While in theory it sounded reasonable to mandate FDIC to take progressively punitive action against a bank as its capital falls towards 2 percent, in this environment it was and is a bank killer. It immediately put you in a death spiral that you could not escape. Capital dried up, liquidity dried up, customers lost confidence, employees left and regulators were no longer allowed to exercise judgment, as they were required to follow a set of draconian guidelines.

And you can't talk about how we got here without mentioning two government programs that have created market disruptions: the Troubled Asset Relief Program (TARP), and the FDIC selling failed banks with a loss-share agreement given to the acquiring bank.

What made it worse?

Most banks in Georgia that have failed have been appraised out of business. To give a specific example of the appraisal problem, in the metro Atlanta area historically the cost of a lot is 20% of the overall cost of a home. That means if you had a new home that cost $200,000 the lot cost would be $40,000. Today the cost of a lot is 5% of the overall cost of a home, meaning that in the same $200,000 home the lot cost is now $10,000. We have gone from a cost norm of 5 to 1 to an abnormal TARP and loss-share induced 20 to 1. This is visually demonstrated by slide 13 which is part of a set of slides I have included in my testimony. There is another slide, slide #20 that shows real estate asset disposals by TARP and loss-share banks. The size of the yellow dot represents the number of lots liquidated and they were all sold at less than $10,000 per lot. Unless you were one of the fortunate ones who received government assistance, you have no chance to avoid significant charges against your capital due to undue influence of government money in the market place. Another example specific to my community was a subdivision where the lots had sold in the $90,000 to $120,000 range in 2007. The loan amount was around $43,000 per lot which at the time seemed to be a safe margin. Most recently those lots were sold for $9,500 apiece by a loss-share bank. That is a decline of 89% at the minimum. This was a fully developed subdivision in a highly desirable area with a first class amenity's package.

Additionally, these types of appraisal-driven declines permeate throughout the local economy. You would think that what it costs to create something would have some relevance to its value, but not in today's world. Under the new appraisal standards many appraisers will tell you that cost is not relevant, all that matters is the market approach and to a lesser extent, the income approach. Therefore, since the market approach is the most heavily favored approach and you have federally funded asset disposals by TARP and loss-share banks we have an incredible disruption in our real estate markets here in metro Atlanta and Georgia in general.

Think about how this affects the general public. Consumers can't refinance their homes to a lower payment because their home won't appraise, municipalities that rely on real estate taxes can no longer fund schools, or police and fire protection, and to make matters worse many bankers are telling me that new appraisals are coming in 40% less than just last year.

In Georgia, until recently building and building-related businesses made up 20% to 25% of our economy. Referring back to the Smart Numbers slides notice slide #15, which shows permits issued since 1996. The norm appears to be 3,500 to 4,000 per year. The current number is around 500, which is a drop of about 86%. In Georgia we have had an industry that represented 20% to 25% of our economy not just slow down, but literally cease to exist.

Another slide that demonstrates the same point is slide #3. Normally, new homes make up about 50% of home sales but most recently they represent less than 10% of the total. This decline is not only a result of lack of inventory from lack of funding, but it is also because of the undue influence of TARP and loss-share money in the real estate market. If you look at slide #8 you will see that the average new home in the first quarter of this year sold for around $225,000 while the average resale was $97,000 primarily due to foreclosures. A lot of the asset devaluation has to do with a regulatory system trying to flush out the system as quickly as possible. As a result, the economy in general is being significantly hindered.

A couple of other accounting-related issues of great importance are Loan Loss Reserves and the Deferred Tax Asset. Historically, banks used the Experience Method (FASB 5) to fund their loss reserve. In May of 1993, an additional loss measure called FASB 114 was put into place, which I will not discuss today. Under the Experience Method banks looked back at their average five year loan losses and set aside an amount that would cover those same losses as if they were going to happen again. In the five year look back some years were better than others and the reserve balanced out. Over the last few years banks have been required to shorten their look back period to anywhere from two quarters to five quarters. This basically has the effect of capturing your worst historical loss periods and having to fund your loss reserve as if it were going to happen again. This has a direct effect on reducing capital since only part of your loss reserve is allowed to be counted toward risk based capital and none of it counts toward tangible equity (which is the ultimate measure under prompt corrective action).

Also of importance is the Deferred Tax Asset. The deferred tax asset is a balance sheet account that is the result of timing differences between financial accounting and tax accounting. A deferred tax asset is a benefit you stand to gain in the future and in our current environment this is primarily a loss carry forward. So if you had a couple of years of net losses, those losses would carry forward to reduce future tax liability when you have net income. Unfortunately regulatory requirements state that you must disallow the amount of your deferred tax asset that you can't demonstrate you can recoup in net income within the upcoming 12 months. When the entire amount becomes disallowed it must be subtracted from tangible equity. In this environment a 12 month look forward for the deferred tax asset should be reconsidered and a longer look forward put in place.

Problems with the loss share

In my home county, Bartow County, there are three loss-share banks. The fact that there are so many loss-share banks in this area has only exacerbated the asset value problem. It is clear to me that loss-share banks stand to make more money by forcing the issue rather than working with the customer. In Georgia, community banks generally do balloon notes on commercial properties. This is done as an interest rate risk management tool. So at the end of 18, 24, or 36 months the entire balance of the loan is due. The commercial loss-share part of the acquiring bank's agreement, 4.15B, is for five years. I fear that as the fifth year anniversary of the loss share agreements comes closer, rather than losing the protection of the loss-share, many of these loss-share banks will pursue judgments and foreclose so as to maximize financial gains regardless of the borrowers' past performance or capacity to pay.

Another loss-share issue is home equity lines of credit. While they generally fall within the provisions of the single family loss-share agreement which is 4.15A (10 year duration), they are specifically separated from the mandatory loss mitigation provisions required for single family loans. Instead, they fall within the other shared-loss loans category which simply requires that the acquiring bank try to mitigate loss consistent with its' own policies. Since this product became popular in the early 2000's and originally had a 15 year maturity (later a 10 year maturity) many will be coming due in the next 4 to 8 years. What could easily happen is the loss-share bank will get an updated appraisal which will probably be valued down and then it will have to mitigate loss consistent with its own policies. Basically this means there will be a whole lot more pressure on an already stressed consumer and since there is no incentive to allow those loans to get outside of the loss share period we could see another round of judgments and foreclosures. As a result I think we will be mired in this real estate mess for quite a long time.

Another problem I see with the loss-share is it does not allow the loss-share bank any judgment in its collection practices. Several months ago one of these loss-share banks in our community filed suit against a borrower. This particular borrower had had a debilitating stroke and would never be able to work again and lost everything. In the prior years the bank would have written the loan off and gone on down the road. I called someone I knew who worked at the loss-share bank and asked, considering the circumstances, why are you suing this person. He simply replied that it is the only way we can collect on the loss-share agreement. I can't imagine that is our government's intent.

In closing, I also want to point out that the regulators I dealt with at all levels were both courteous and professional, and I do not believe they take any joy in closing banks. I also want to point out, particularly during the prompt corrective action process, that I was told many times by the regulators that their hands were tied. They had no choice than follow the requirements of prompt corrective action. Therefore it is clear to me it is not an issue of regulators; it is an issue of regulations. So if this committee truly wants to make a positive change it is going to have to come on a legislative level, not a regulatory level, to deal with these particular issues.

Again, I would like to thank you for inviting me to be a part of this hearing and it is my hope that something positive will come from it.

Clayton County

Lake Spivey
Country Club

Property History

Home sold new in 1993 for $216,000
Sold 6/24/2005 for $343,000
Sold 9/22/2005 for $440,000
Sold 1/12/2006 for $480,000

Listed 11/6/2007 $334,400
Reduced to $274,900
Expired 11/30/2008

Re-listed after foreclosure at $251,900

Sale Price/Original Foreclosure List Price
54.1%

Sold 4/22/2009 $136,500

Total Days on Market
533

The Reserve at Timberlands (Paulding County)



FORECLOSURE

Lot Prices and Date Sold

$62,000 8/7/06 — $45,000 1/29/07 — $45,000 1/29/07

List Date for all 3 Homes 12/12/08

List Price: $299,900 — $349,900 — $349,900

Listings Expire 12/11/09

Homes Re-listed 2/2/10

List Price: $222,900 — $229,900 — $239,900

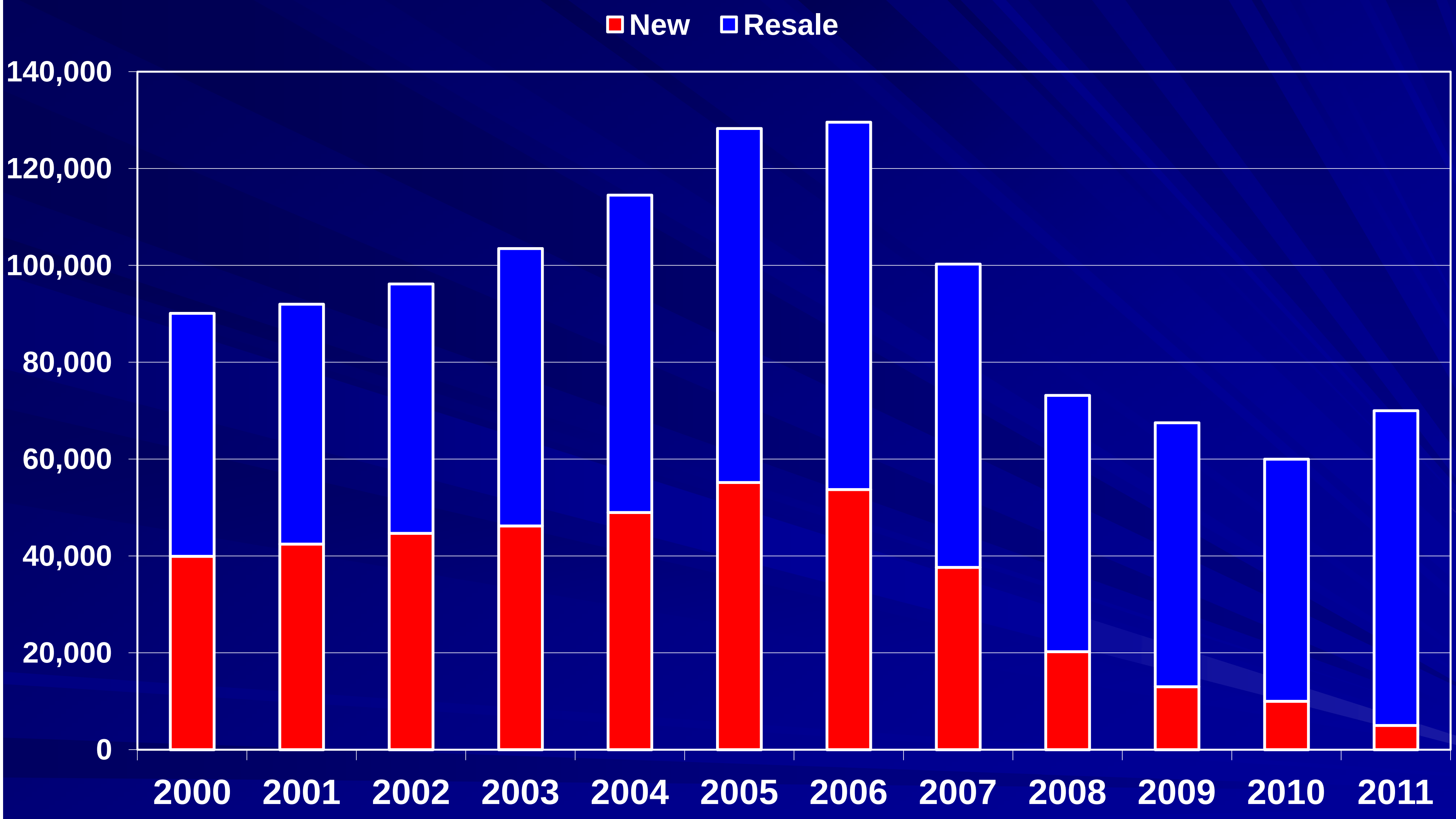
All 3 Homes Sold 6/30/2010

Sale Price: $80,000 — $85,000 — $85,000

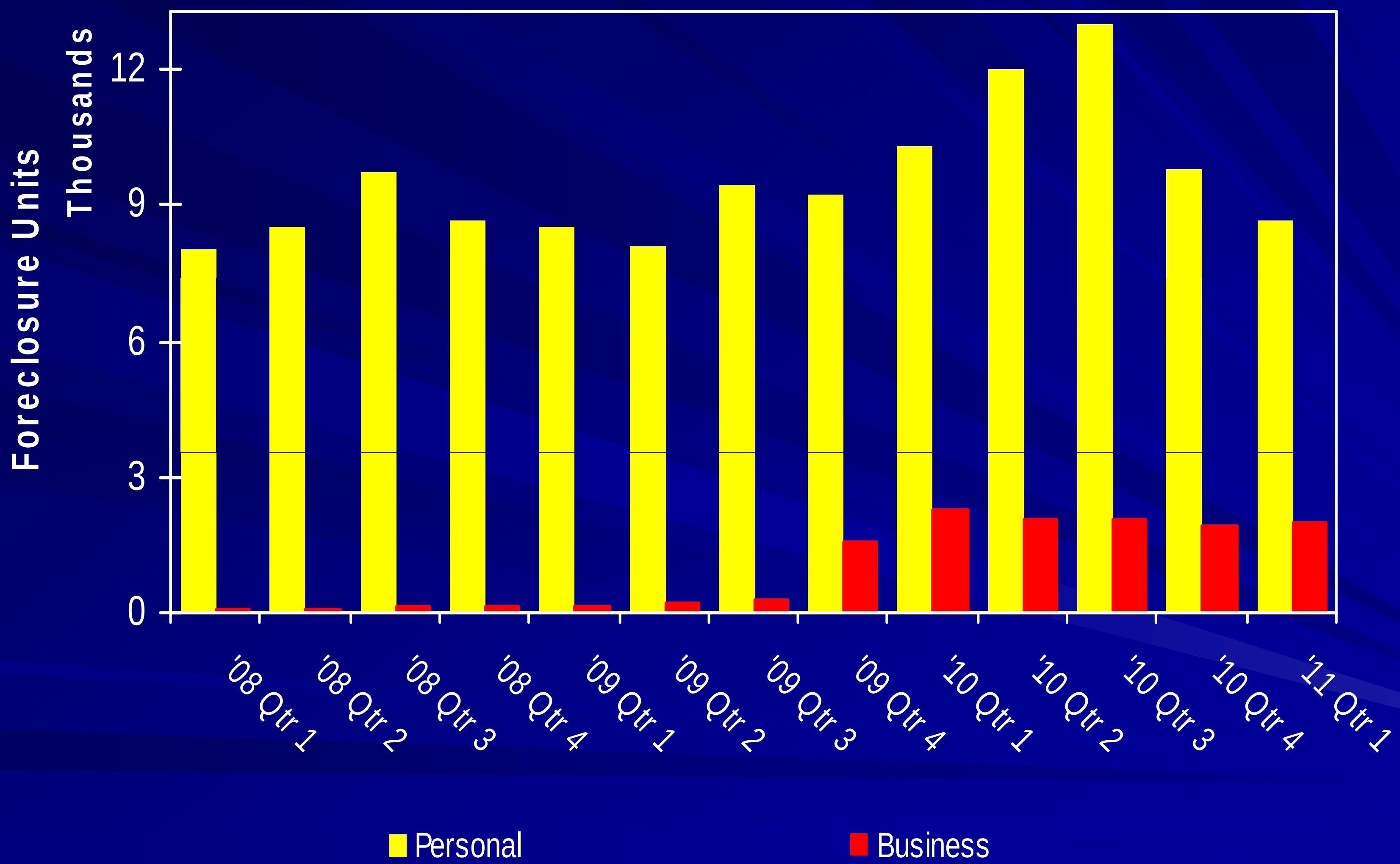
Total Sale Price / Original List Price = $250,000 / $999,700 = 25%

Lot Ratio = Total Sale Price / Total Lot Price = $250,000 / $152,000 = 1.64

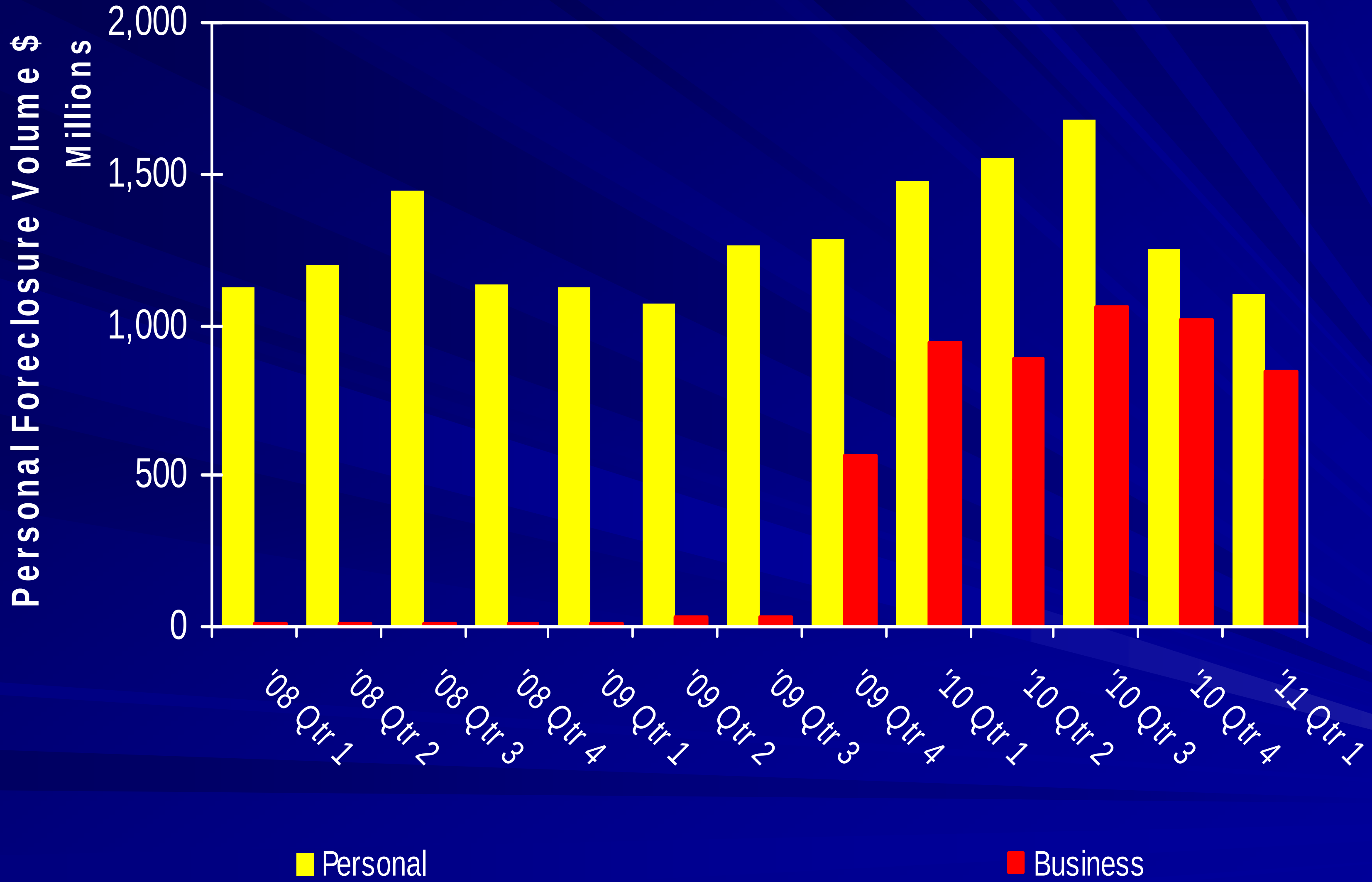
Atlanta Total Closings



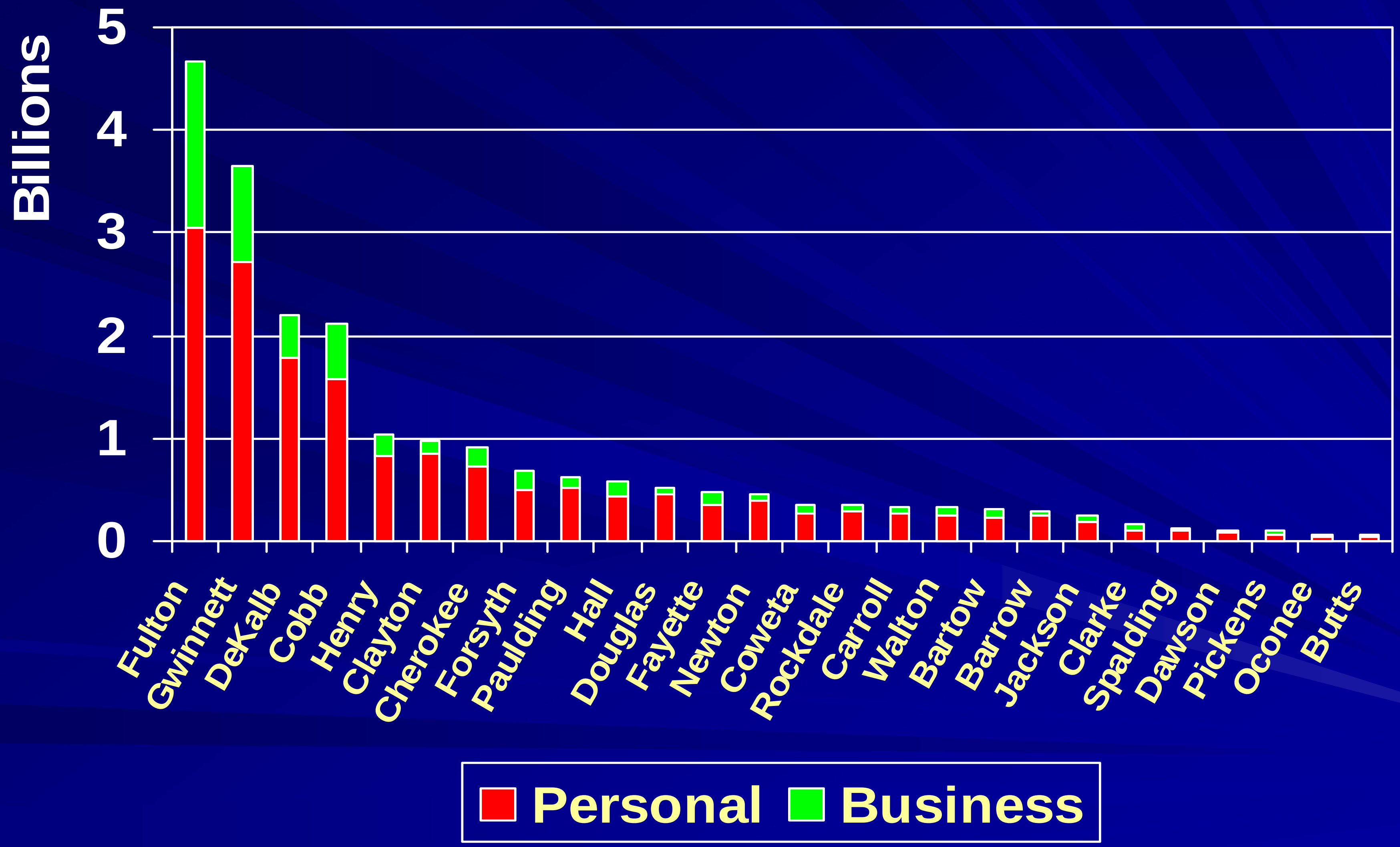
Foreclosure Units by Qtr



Foreclosure Volume by Qtr

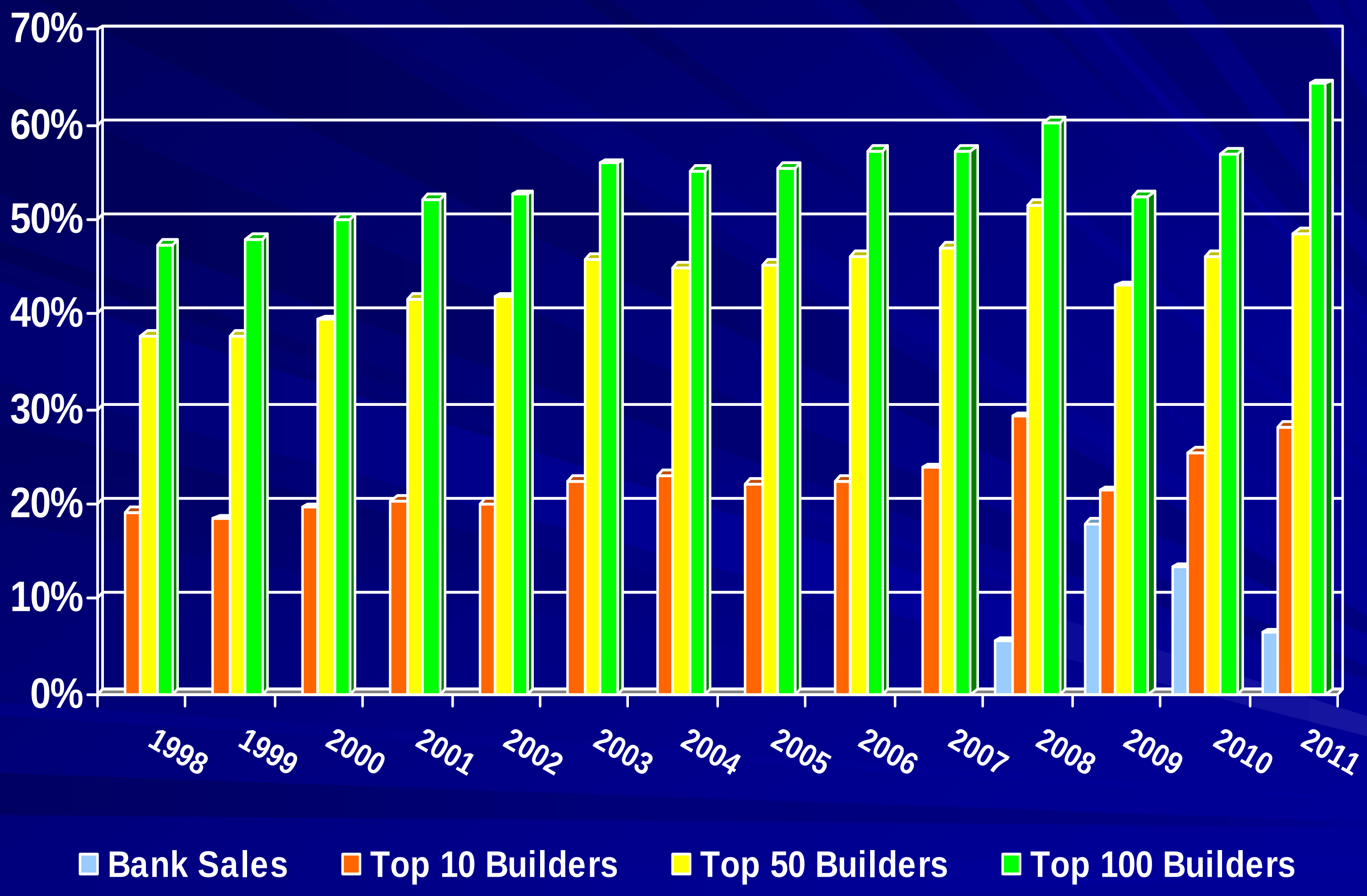


Foreclosures 2008-3/2011

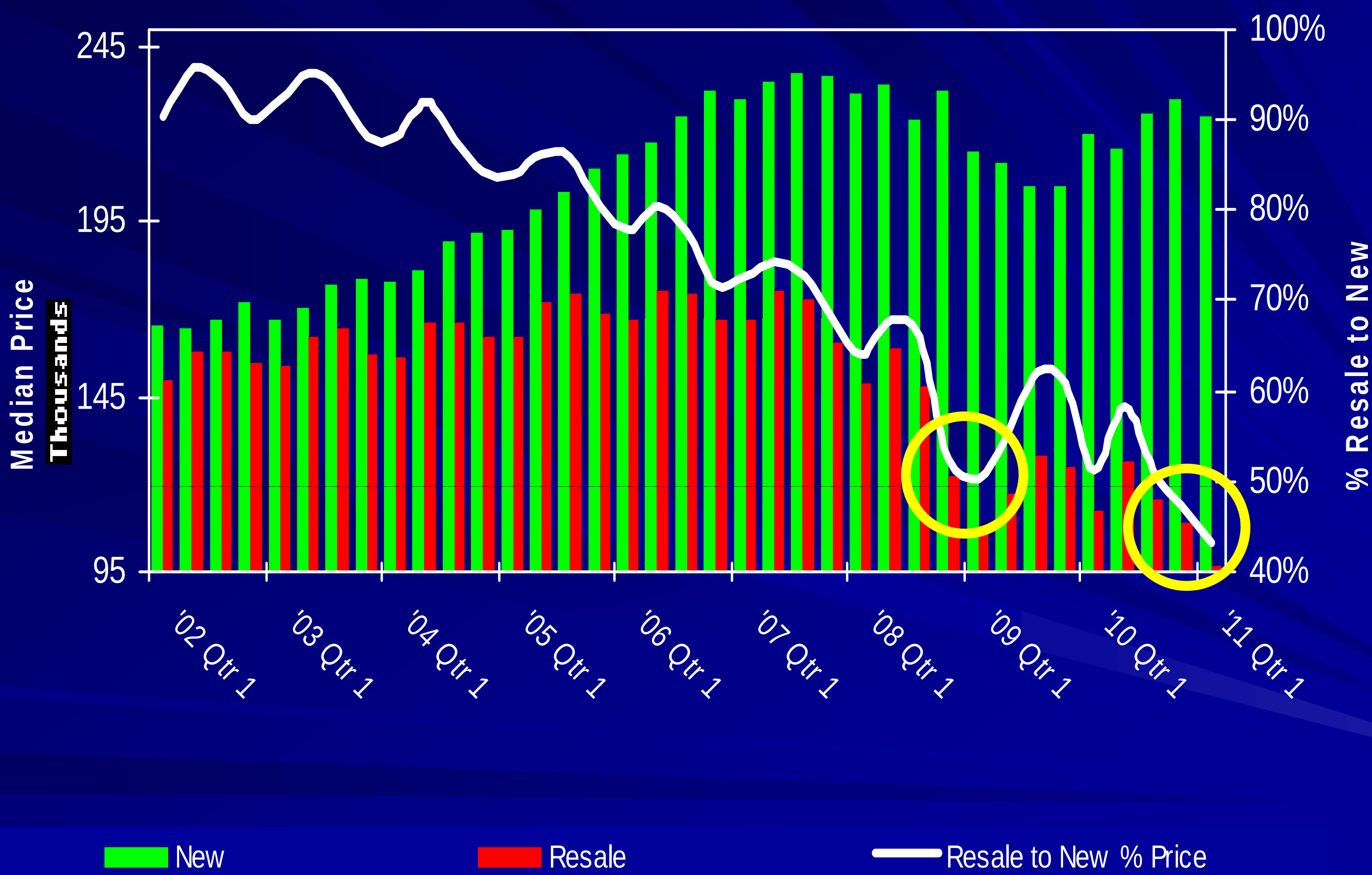


Top Builders Market Share

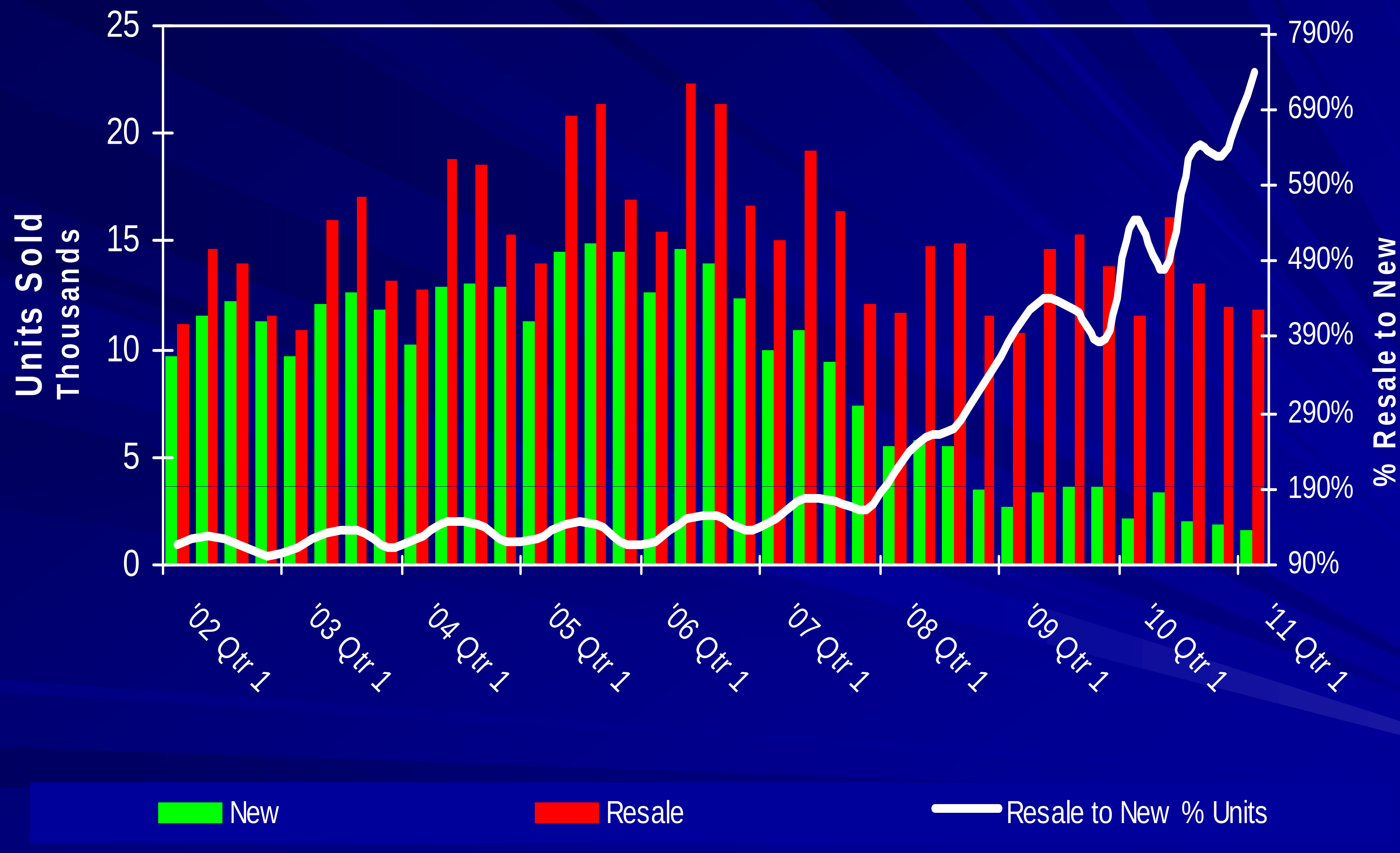
Including Bank Sales



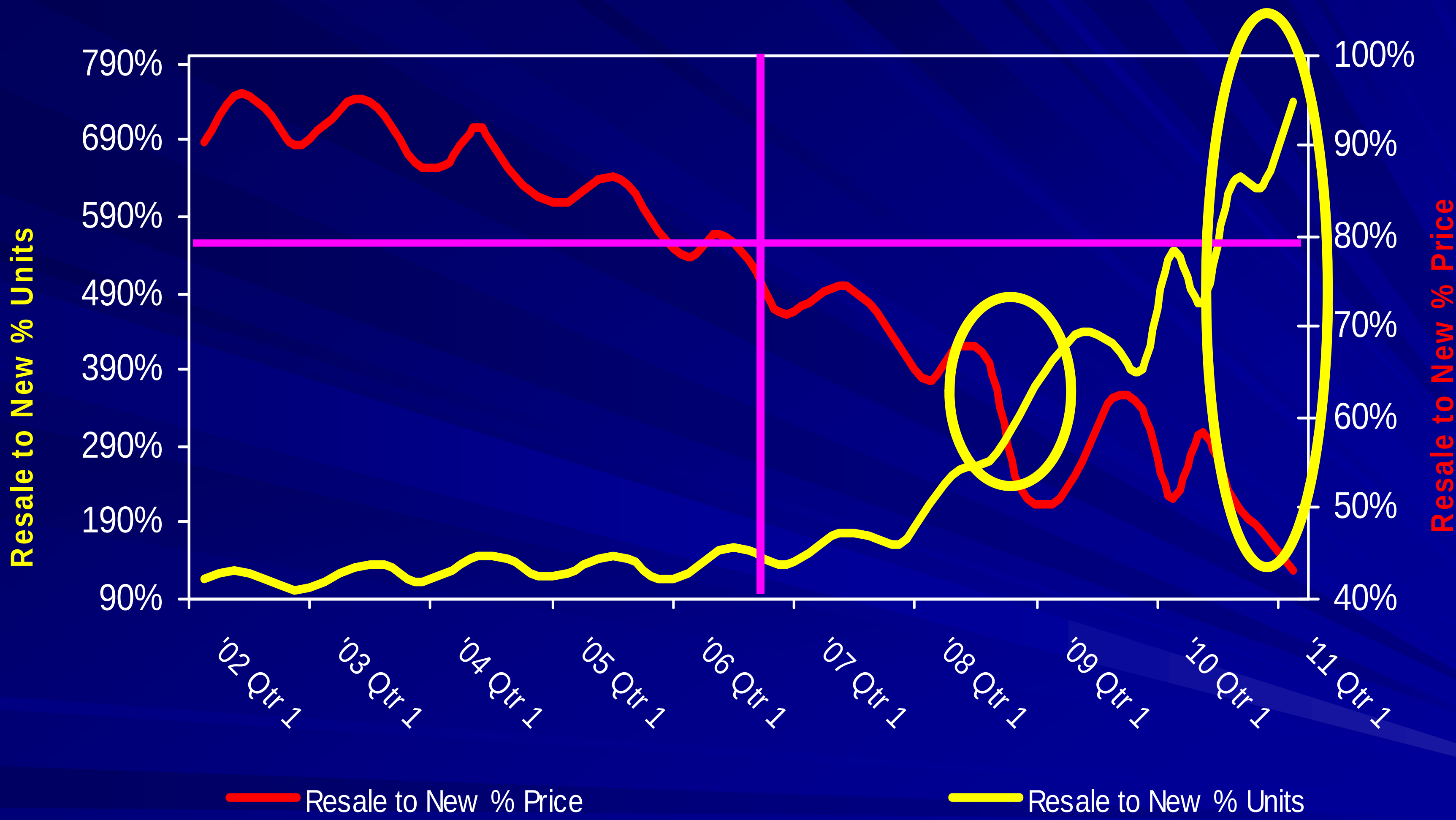
Median Price Total



Units Closed Total



Radical Change in Price Results in Radical Change in Demand



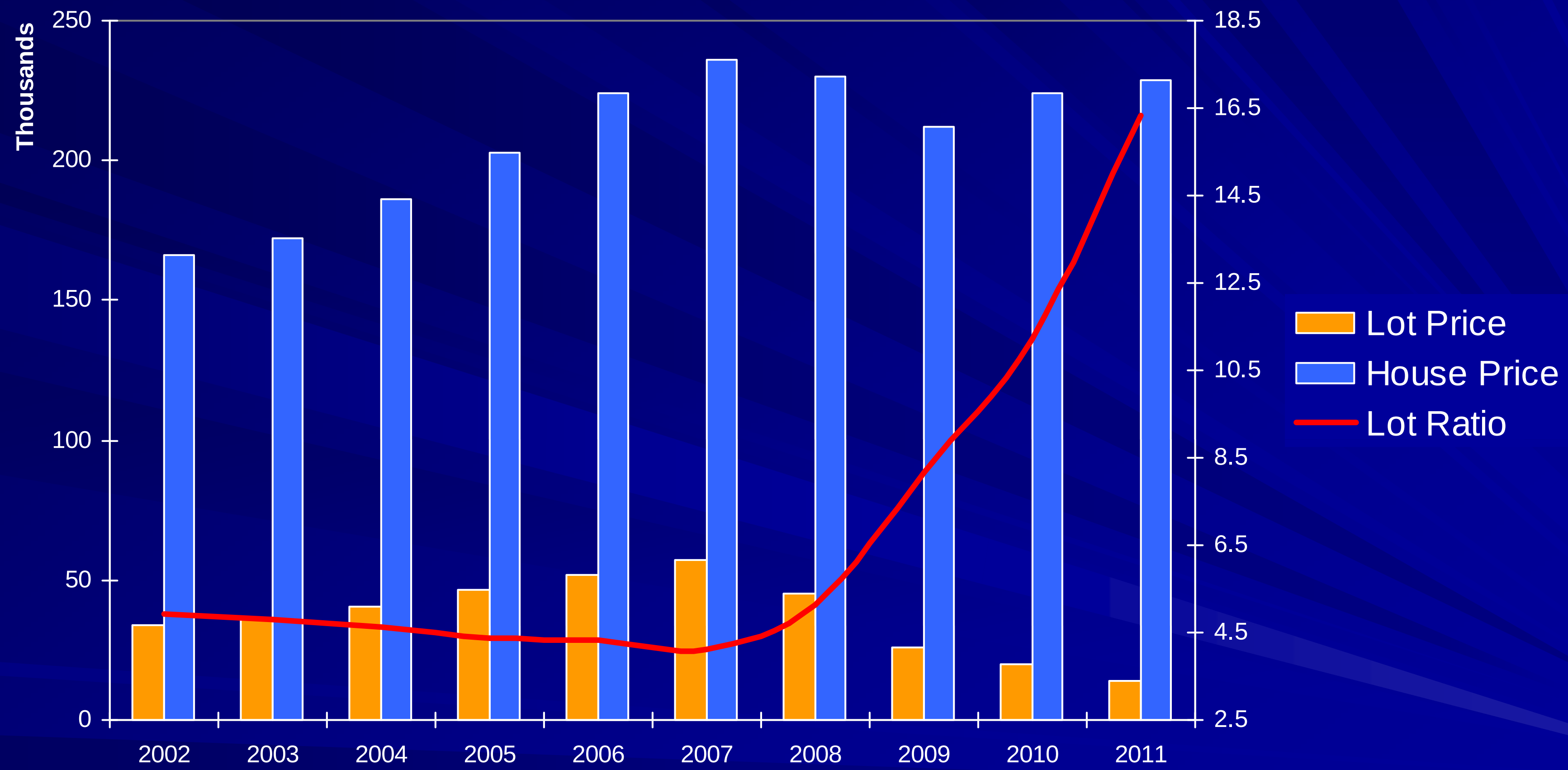
Lot Prices Crash

Lot Price Increase vs. Home Price Increase

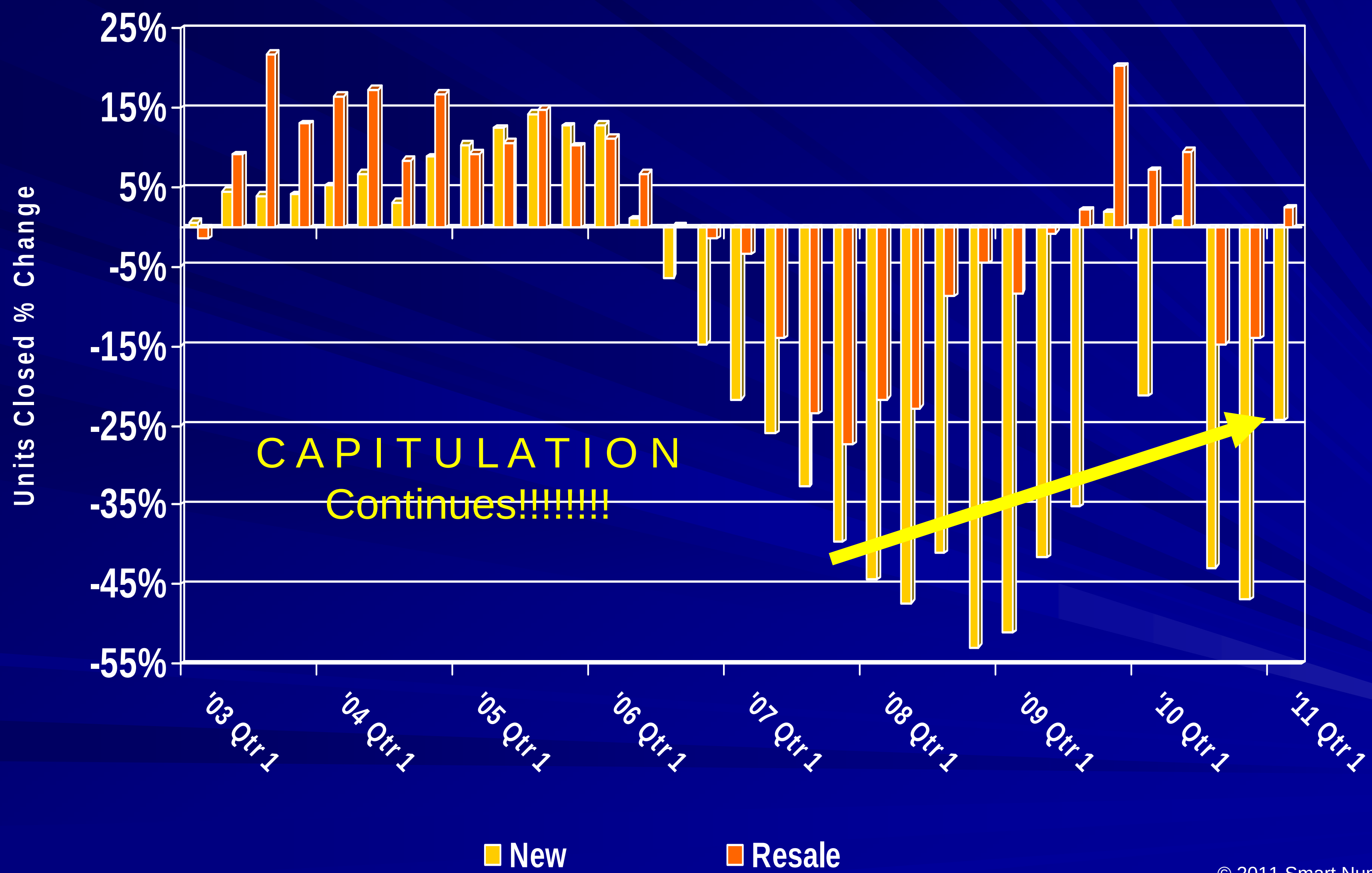
Median Lot & Home Price

Lot Ratio

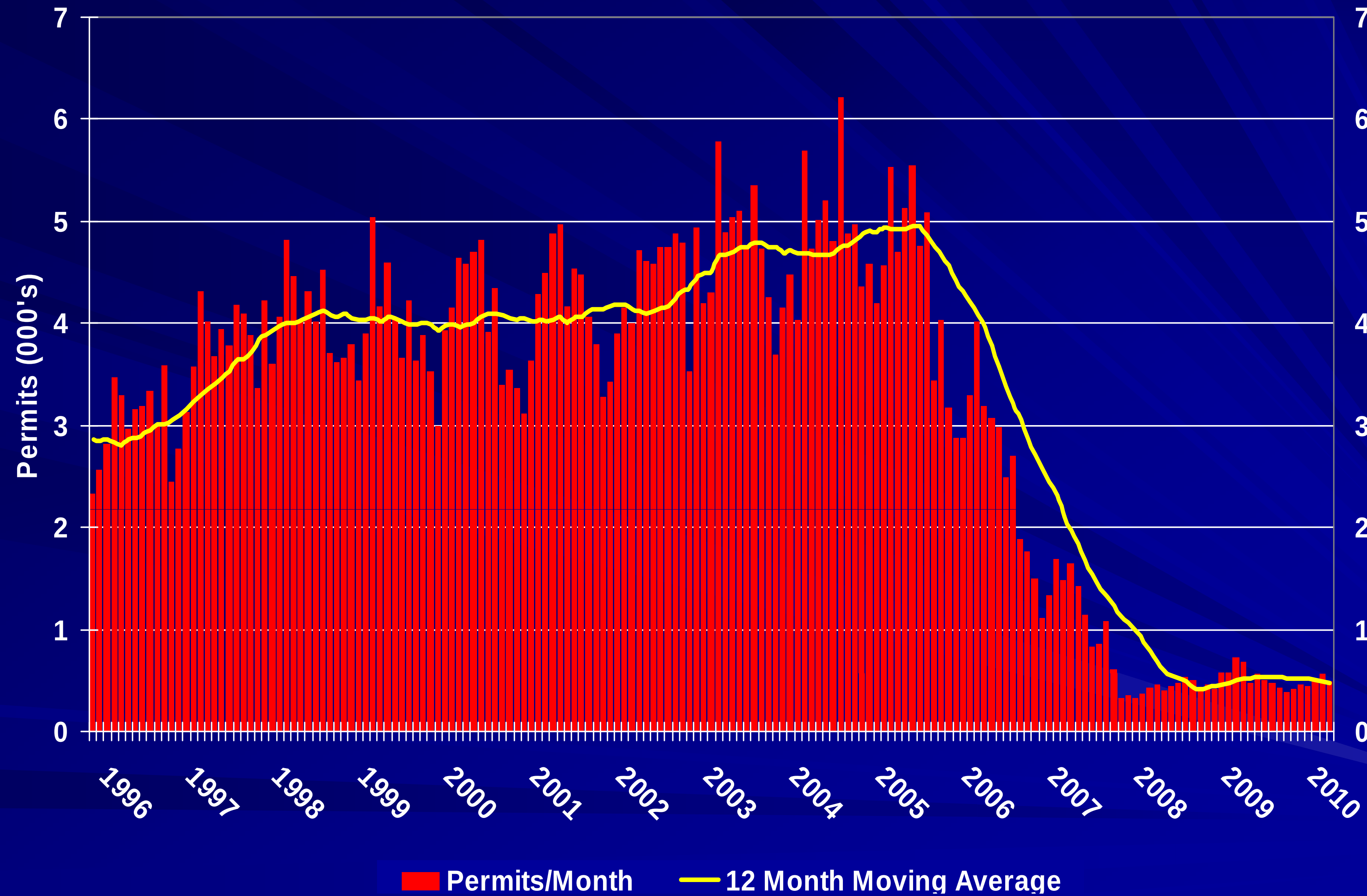
Median Prices



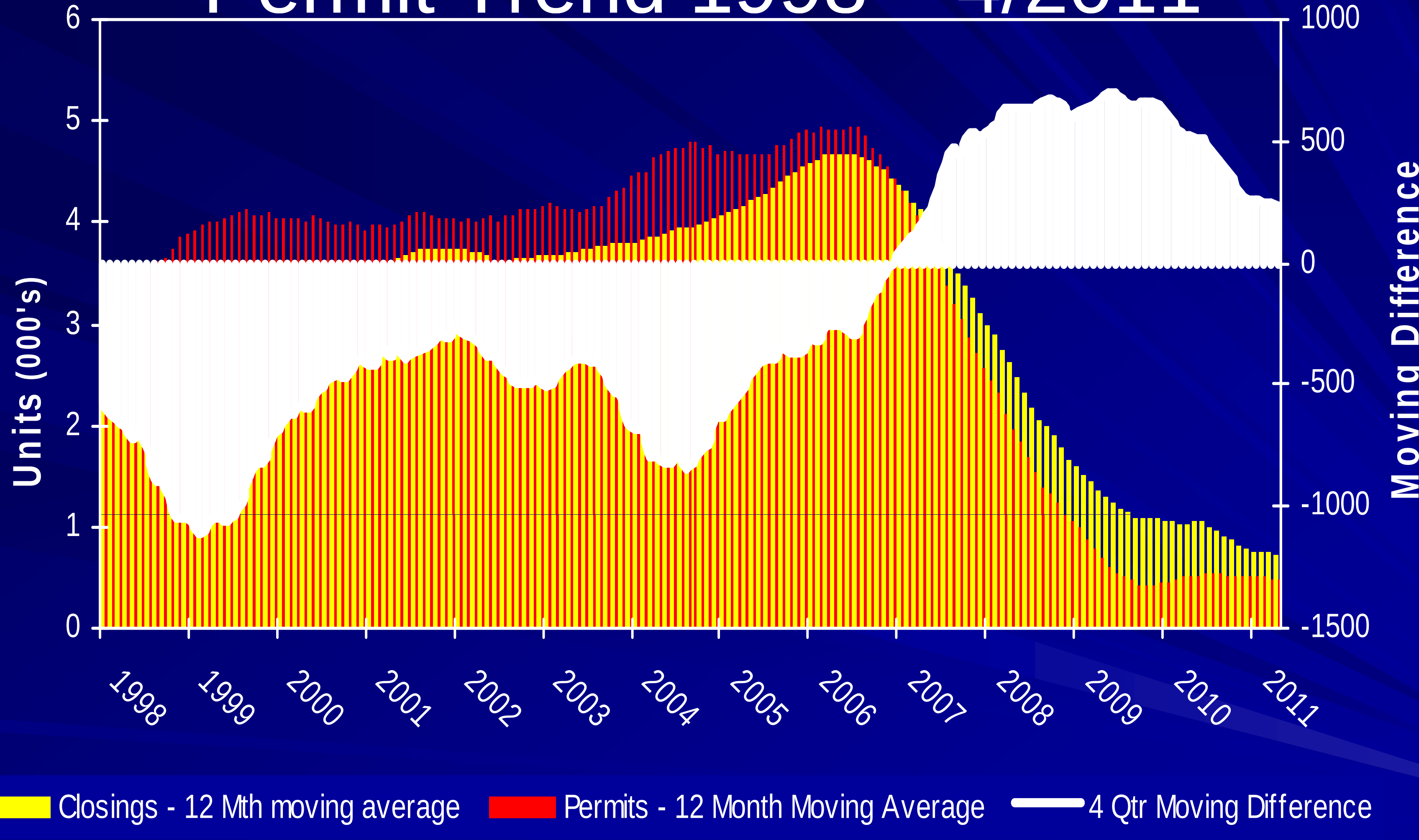
Total Units Closed Year to Year % Change



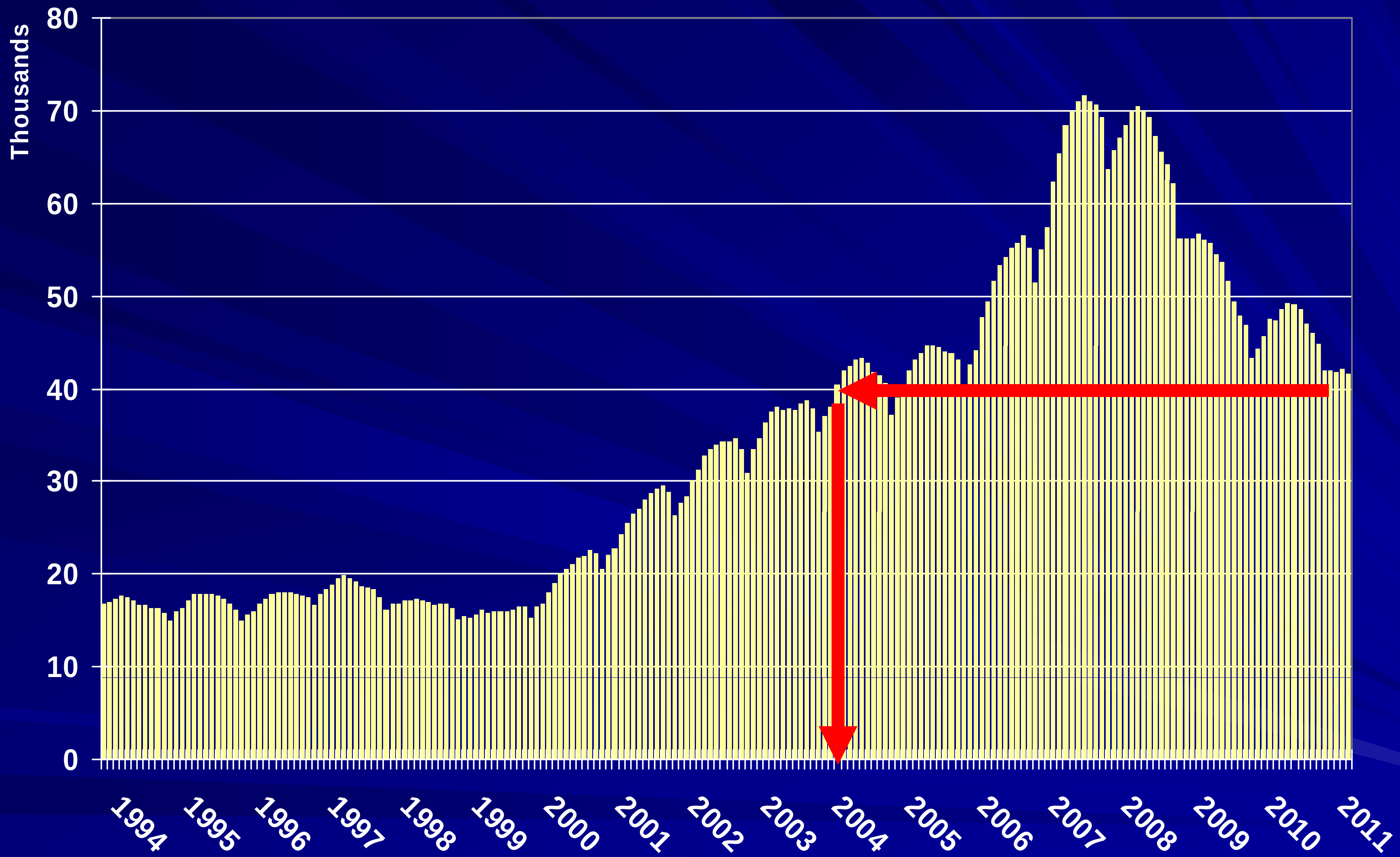
Permit Trend 12/1996- 4/2011

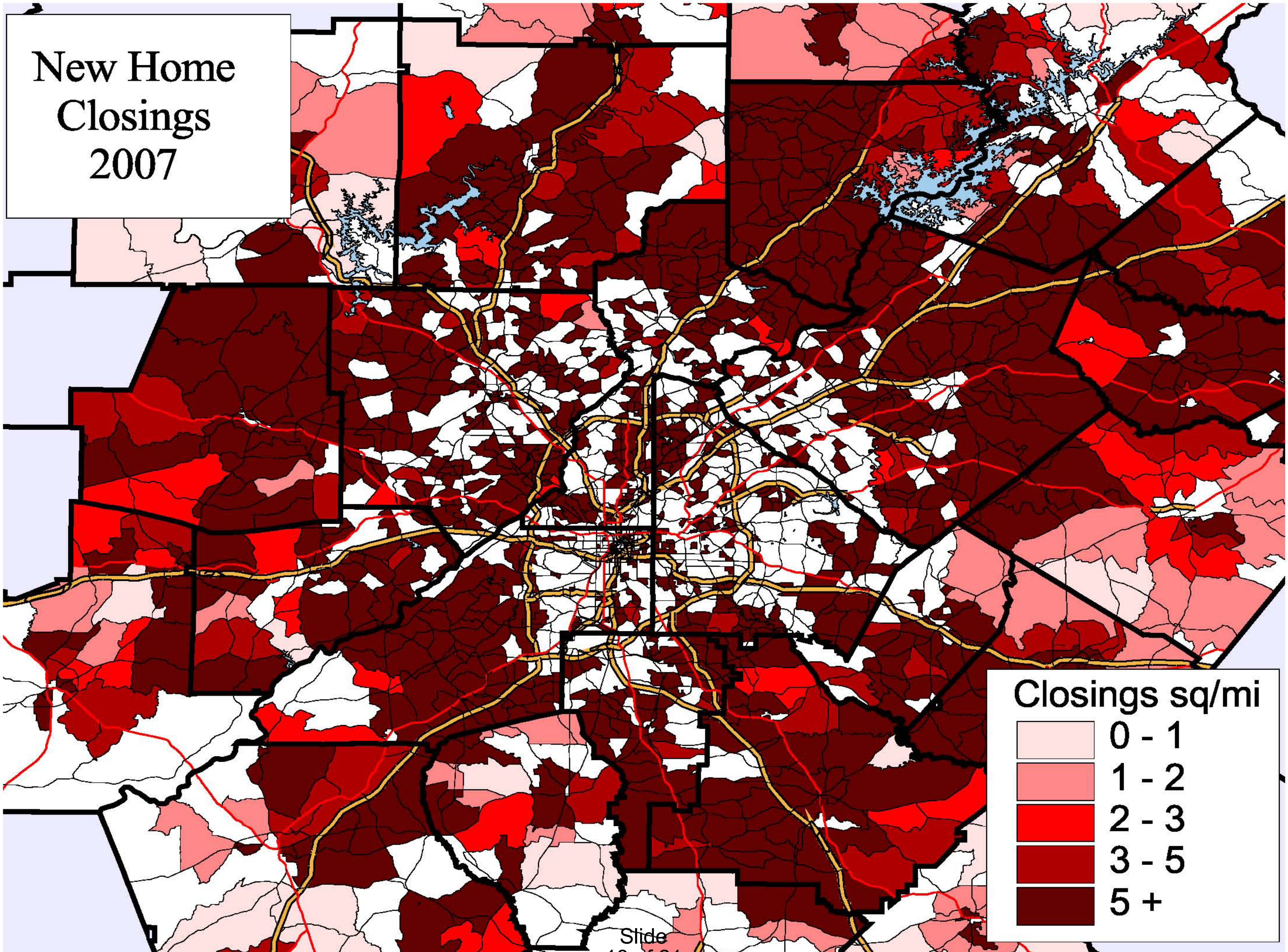


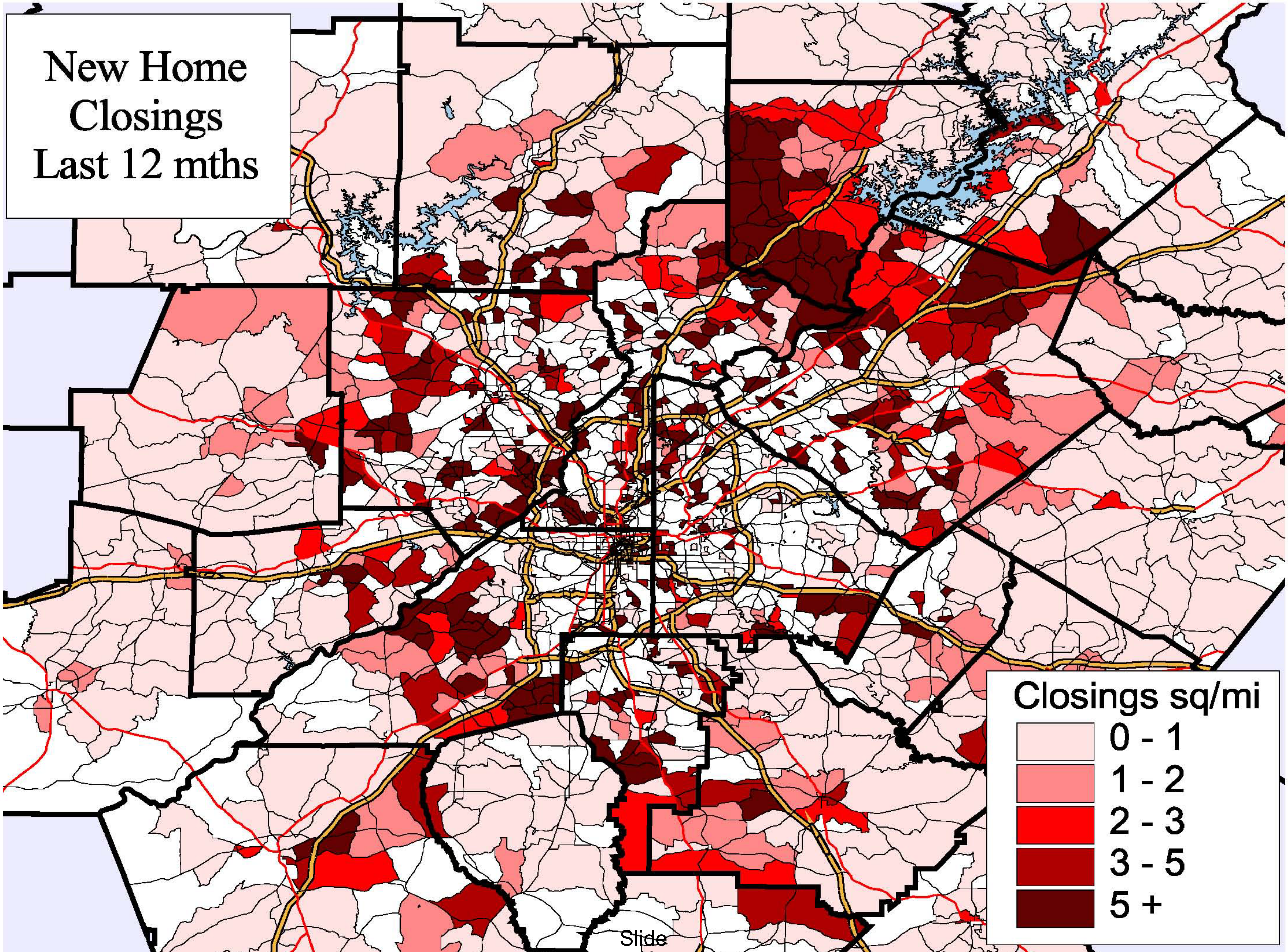
Permit Trend 1998 – 4/2011

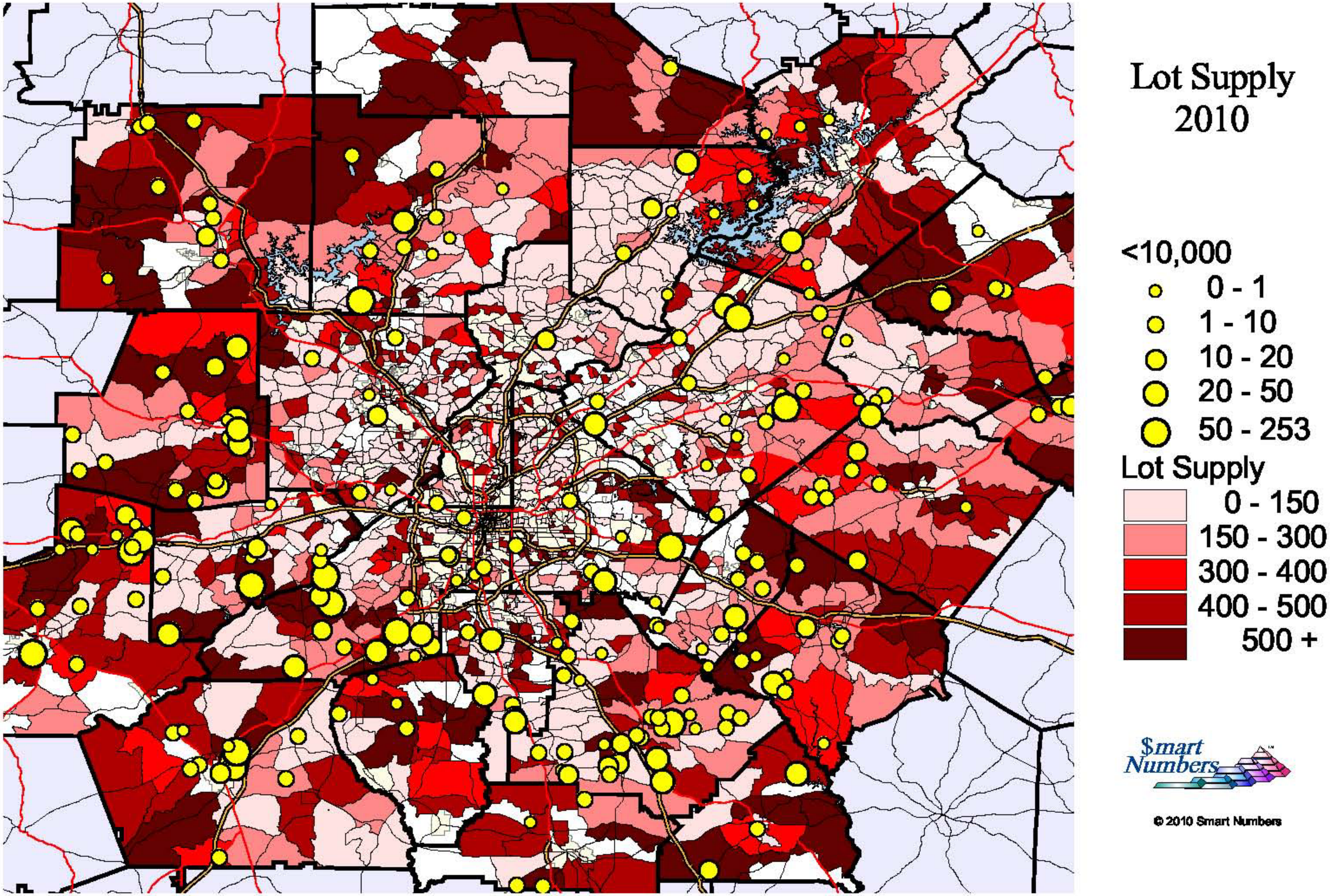


Inventory – All Residential




New Home Closings 2007
Closings sq/mi
0 - 1
1 - 2
2 - 3
3 - 5
5 +


New Home Closings Last 12 mths
Closings sq/mi
0 - 1
1 - 2
2 - 3
3 - 5
5 +


Lot Supply
2010
<10,000
0 - 1
1 - 10
10 - 20
20 - 50
50 - 253
Lot Supply
0 - 150
150 - 300
300 - 400
400 - 500
500 +
$mart
Numbers
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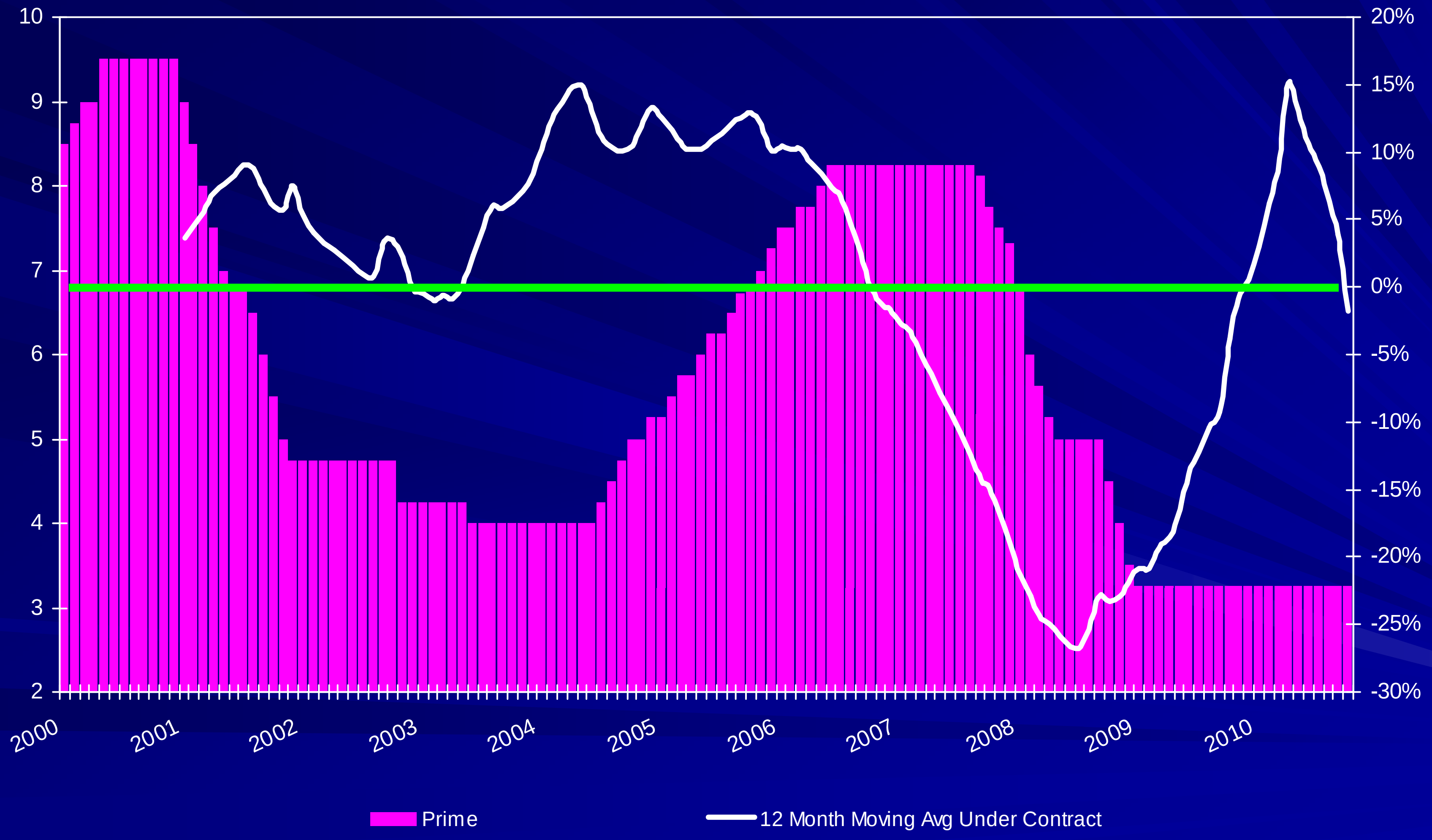
Under Contract Trending Plus Prime

40 months Up – 35 months Down - 11 Months UP & Now 6 Months DOWN?



United States House of Representatives
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Gary L. Fox	
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.