Is it a New World or a return to the Old World?

FinPro, Inc.

November 6, 2008

FinPro
Building value together
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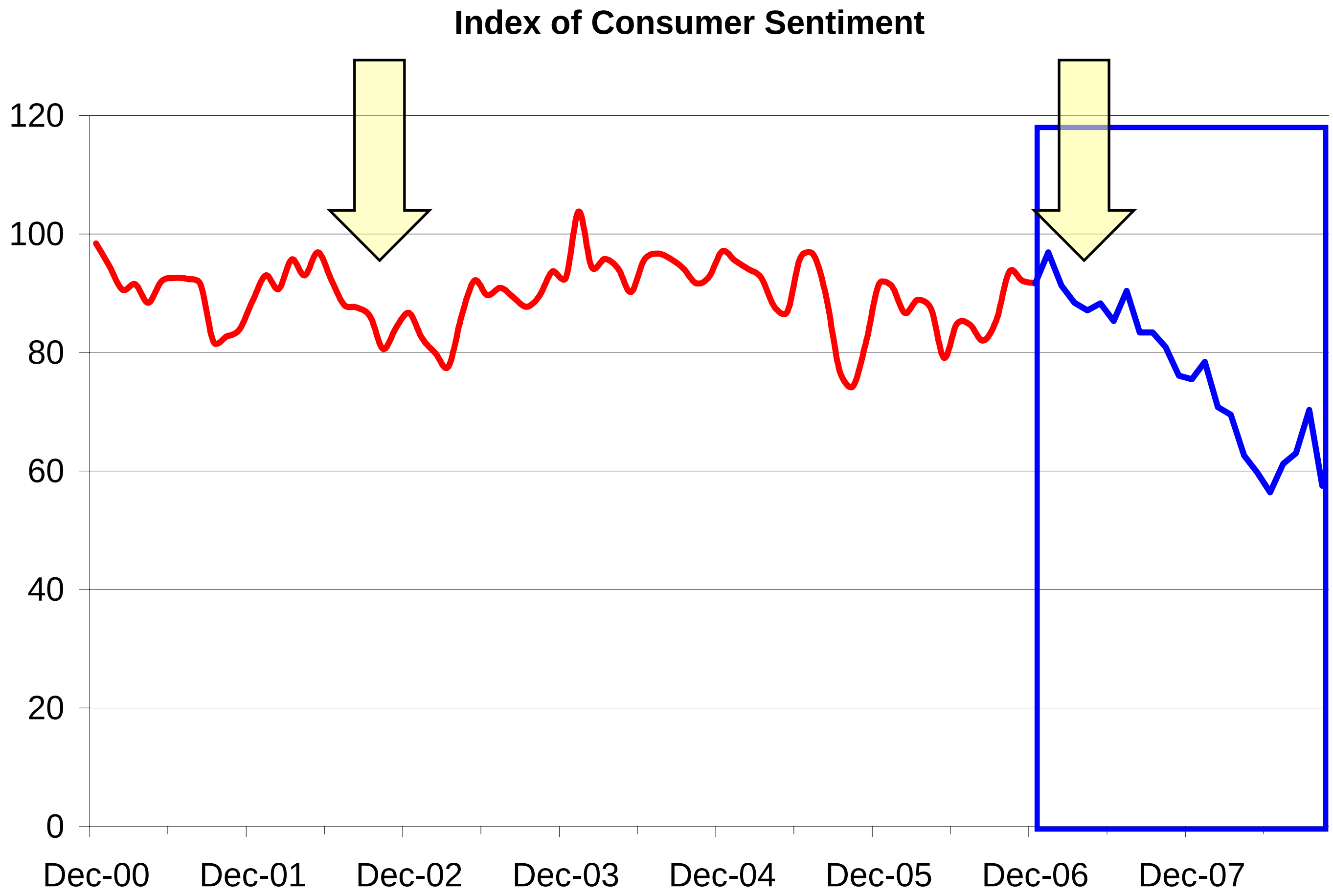
Good Morning and Welcome . . .

- It is hard to believe but this is our 6th annual conference
- FinPro thanks each of you for coming
- To our clients, thank you for placing your trust in us – we won't let you down
- To our partners, we avoided a lot of pitfalls this year. Now we must focus on building the business again.
- Although times are tough, banks can thrive in the upcoming months ahead.
  - We must plan for multiple contingencies and confront the new reality
  - We must plan for the future, not wish for the past
  - We must EXECUTE

I thought it would be fun to look at what we told you last year, before Ed Gibney demands it anyway, and look at how well we did . . .

- Last September, we told our Partners, in a speech entitled “Navigating Turbulent Times” (downloadable from the FinPro website at www.finpronj.com) the following:
- FinPro warned that the Country faced two paths – Only last year we thought it was Clinton vs Giuliani
  - Boy do I long for those days and that choice
- Everyone needs to face facts – we can no longer afford to fund the excessive government now in place. We are collapsing under the weight of it.

Consumer Sentiment was trending down and we cautioned against it falling further. In fact we showed how it paralleled 2002 recession levels . . .



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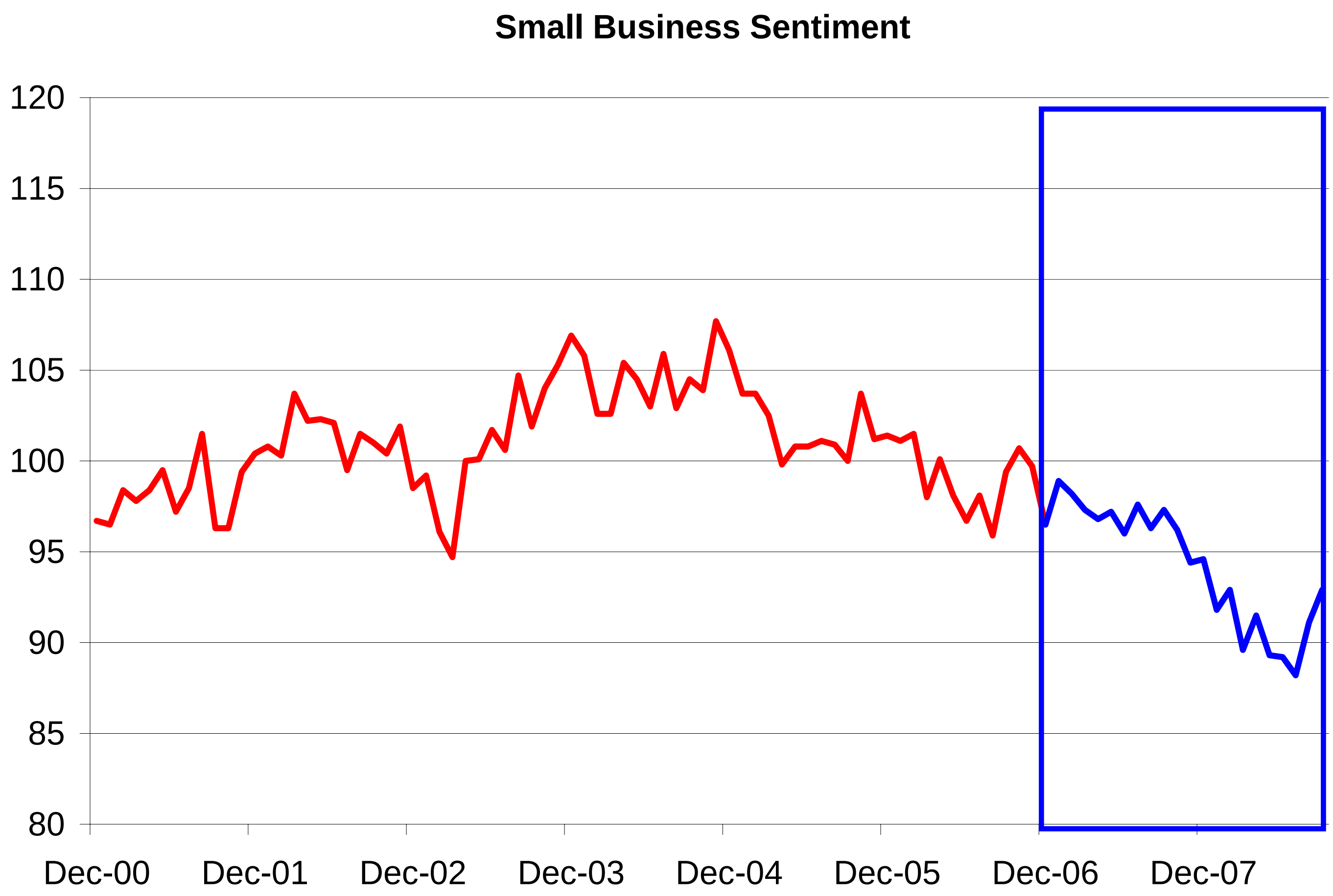
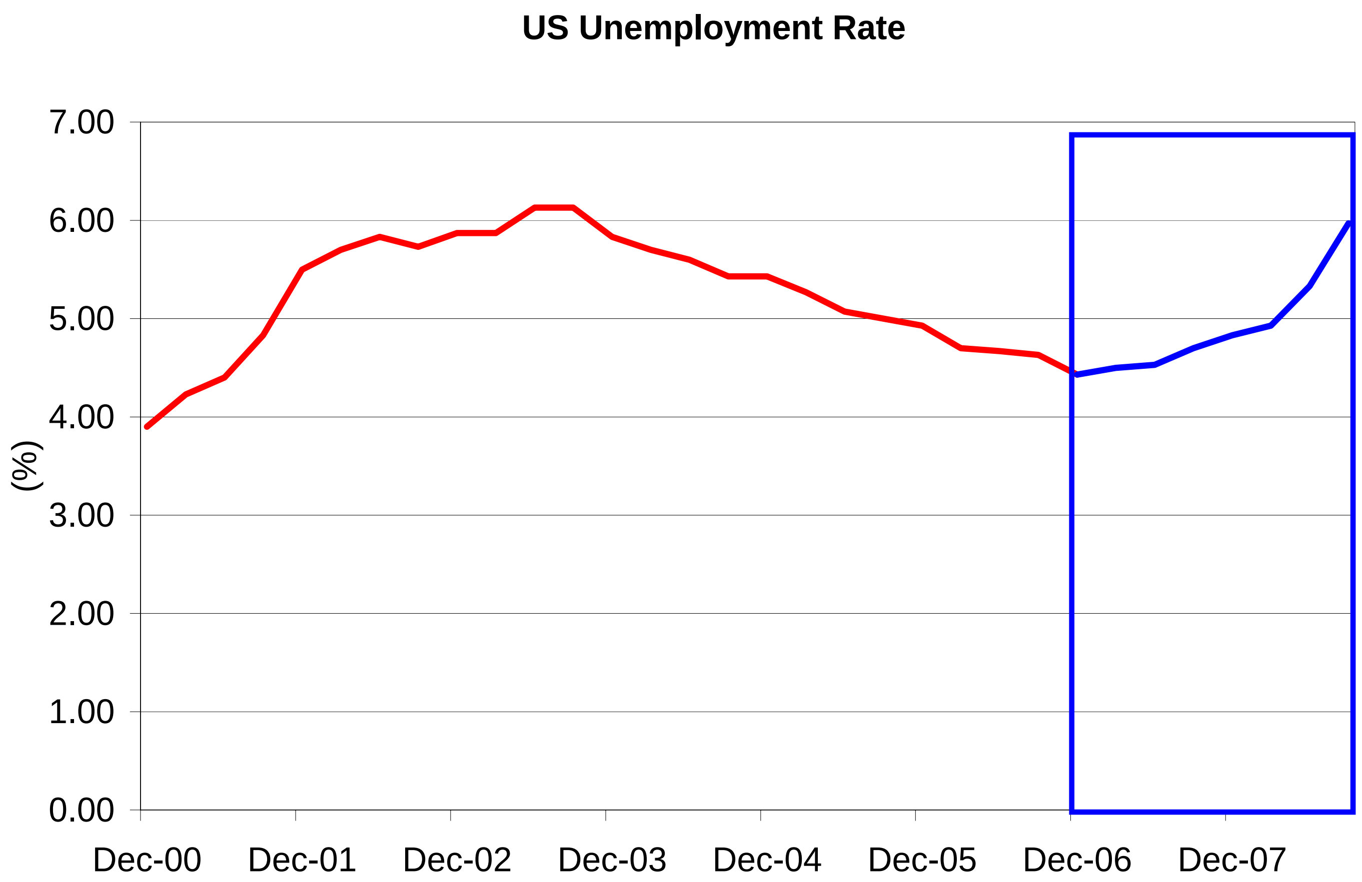
Small business sentiment was falling even quicker and was the precursor to “bad times”.



Unemployment was at record lows, but trending upward and the yield curve was steepening quickly, both precursors to an economic downturn . . .



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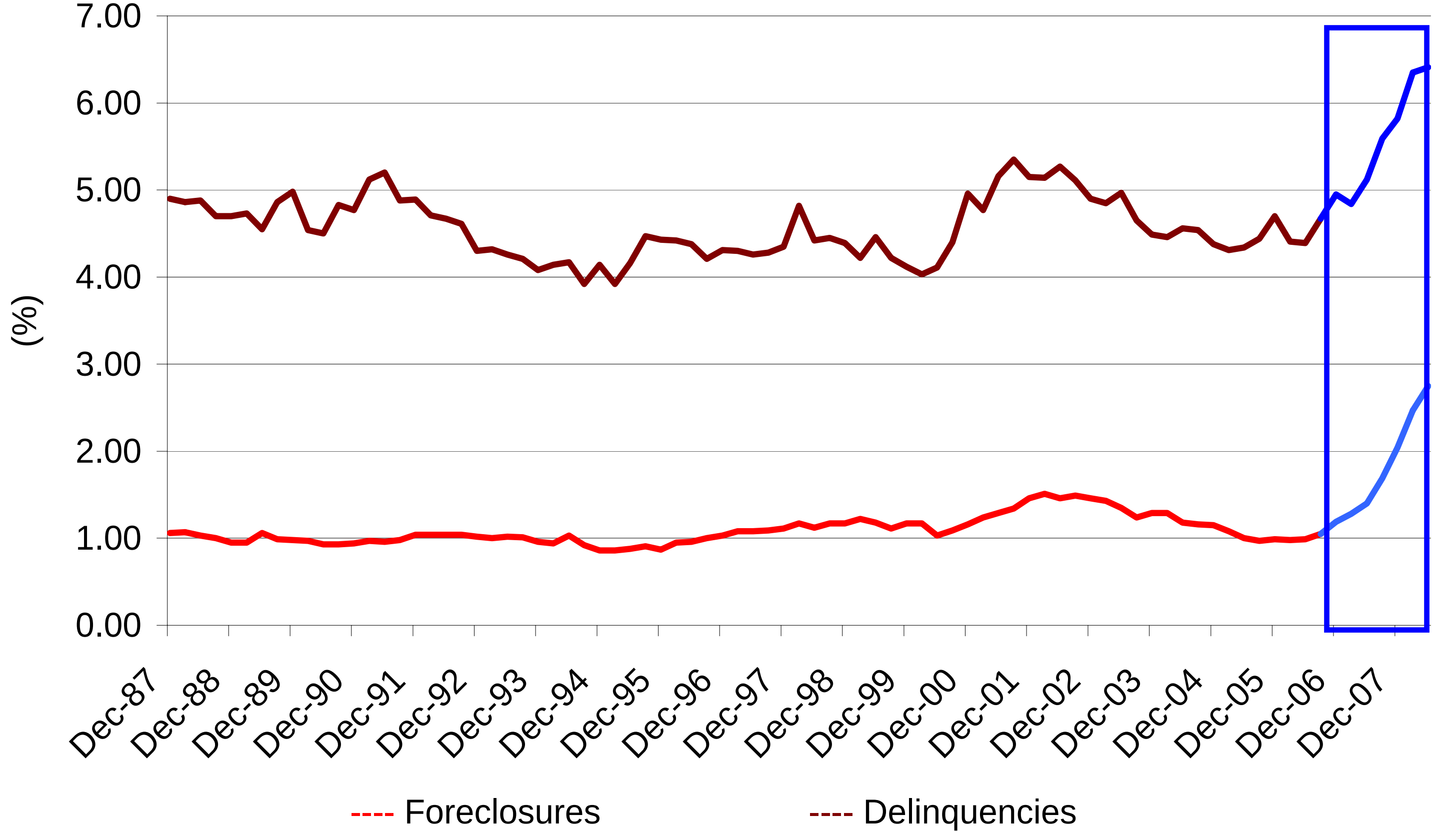
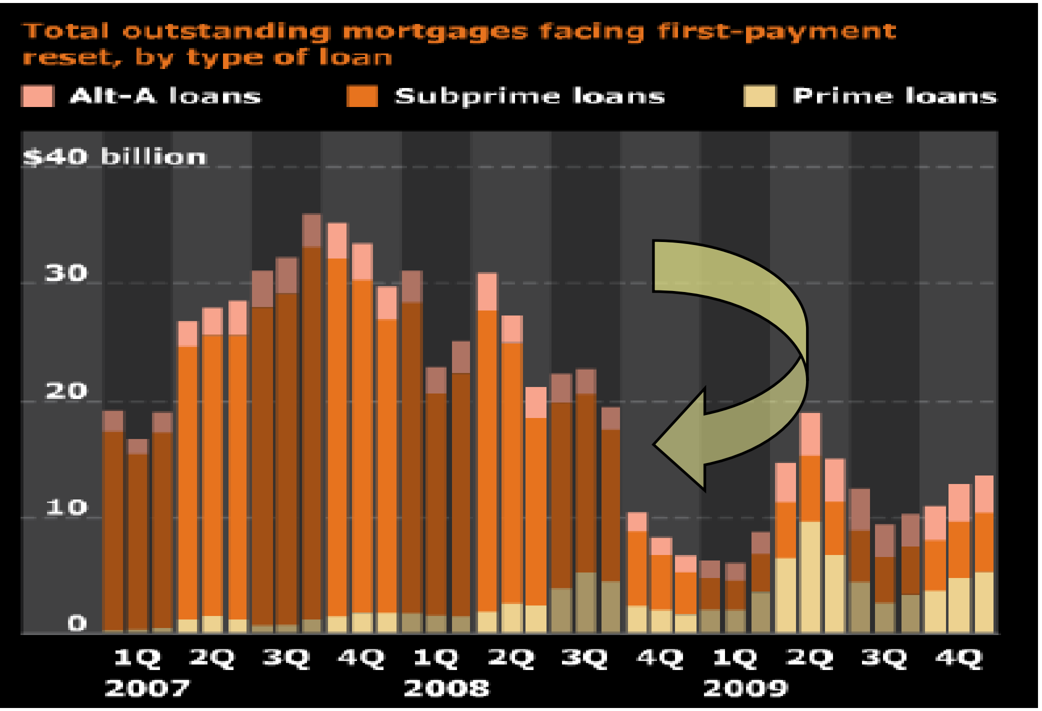
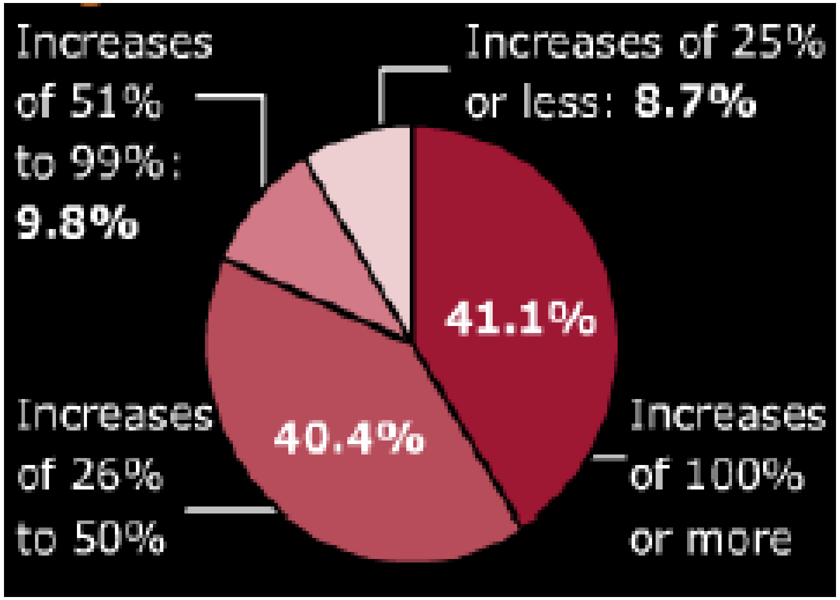
Real estate foreclosures were rising and we pointed to the ARM reset problem as being monumental . . .

Delinquencies and Foreclosures as a % of Total Loans



This is why the Fed had to lower rates. We should also expect new regulations on ARMs to prevent reoccurrence . . .



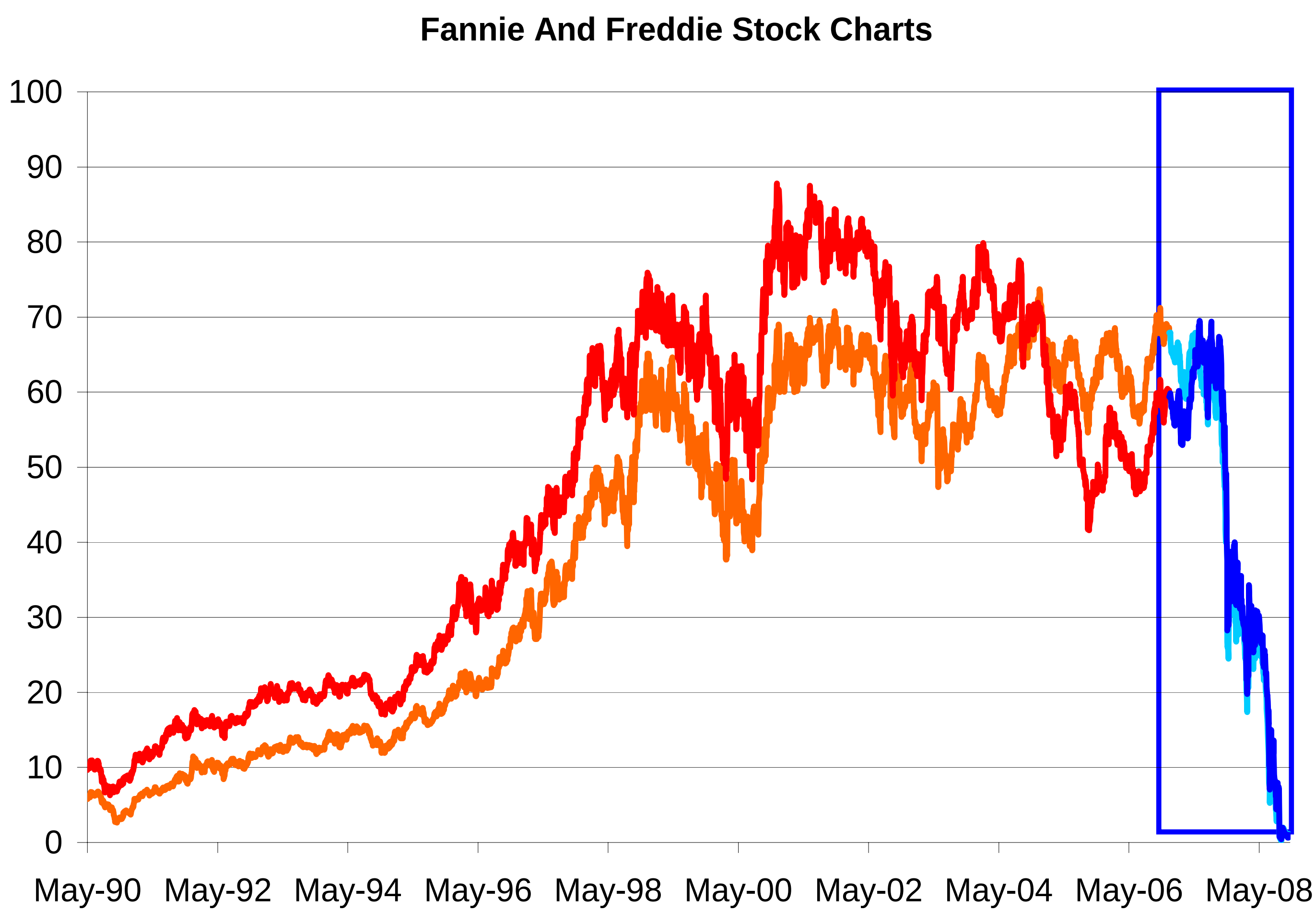


FinPro expressed concern for FNMA and FHLMC to collapse . . .

Credit default spread of FHLMC and FNMA borrowings have widened dramatically

The markets are pricing credit default risk into government sponsored entities!

And in fact, it did . . .



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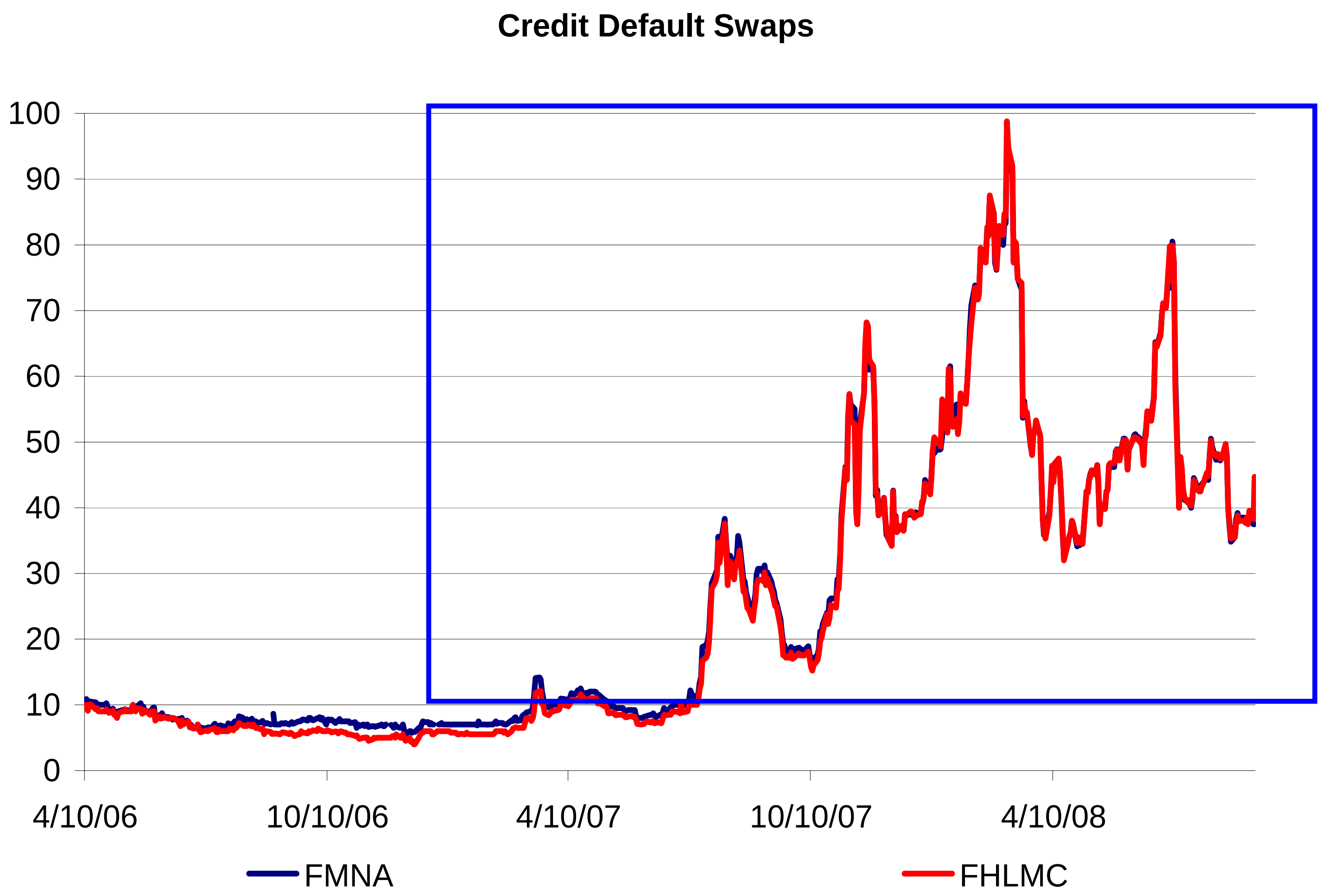
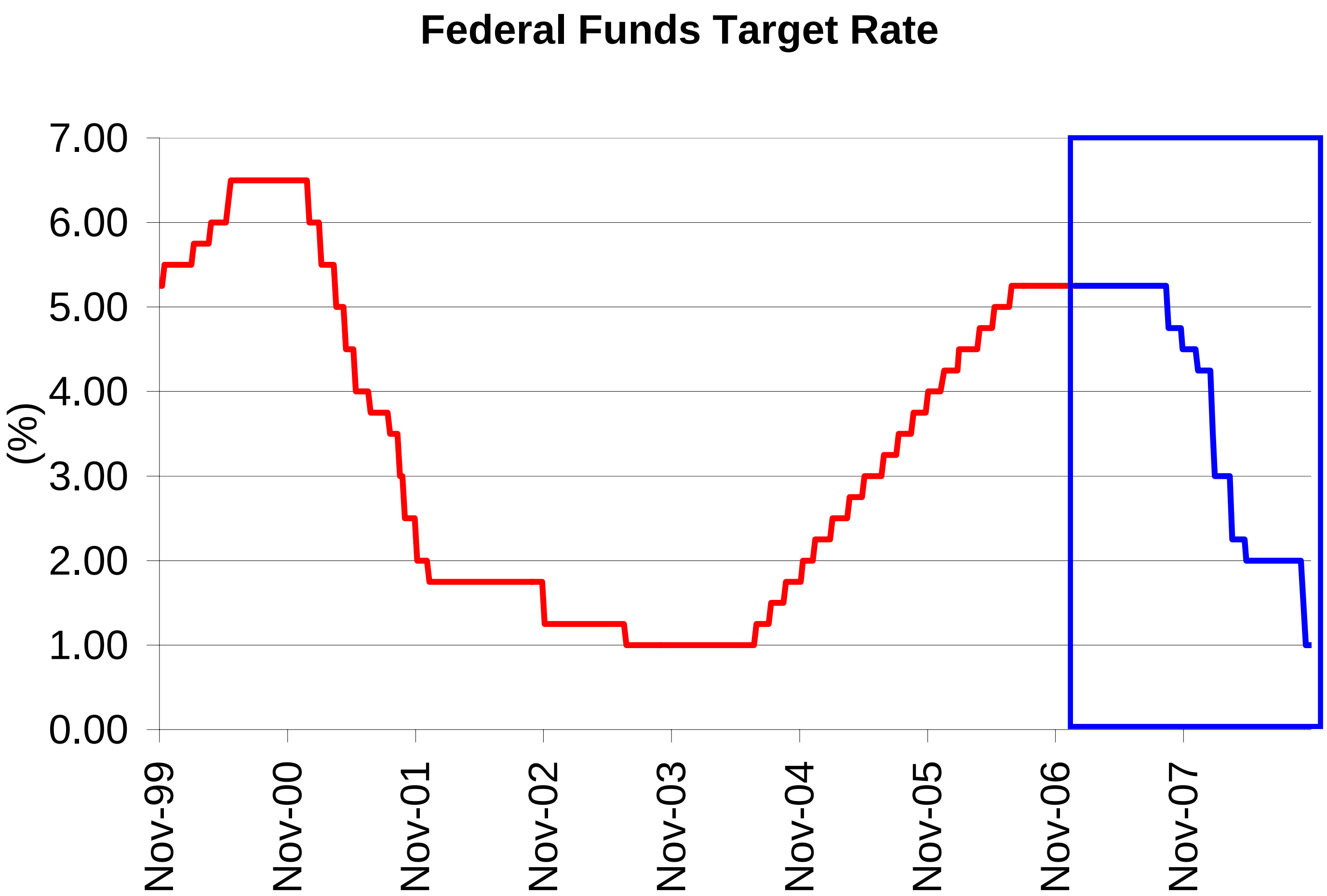
The Credit Default Swap market went wildly out of control in 2007 and early 2008. Such speculation is never good.



FinPro predicted Fed movement downward and the resurgence of regulation. I got ridiculed for this prediction . . .



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I can't figure out why McCain didn't use this chart. Every time a democrat gets elected President, marginal tax rates go up.

Applicable Year	Income brackets	First bracket	Top bracket
1971-1981	15 brackets	14%	70%
1982-1986	12 brackets	12%	50%
1987	5 brackets	11%	38.5%
1988-1990	3 brackets	15%	33%
1991-1992	3 brackets	15%	31%
1993-2000	5 brackets	15%	39.6%
2001	5 brackets	15%	39.1%
2002	6 brackets	10%	38.6%
2003-2008	6 brackets	10%	35%

Jimmy Carter

Stagflation / Oil Crisis Recession

Ronald Regan

Ronald Regan

Bush 41

Early 90's Recession

Bush 41

Bill Clinton

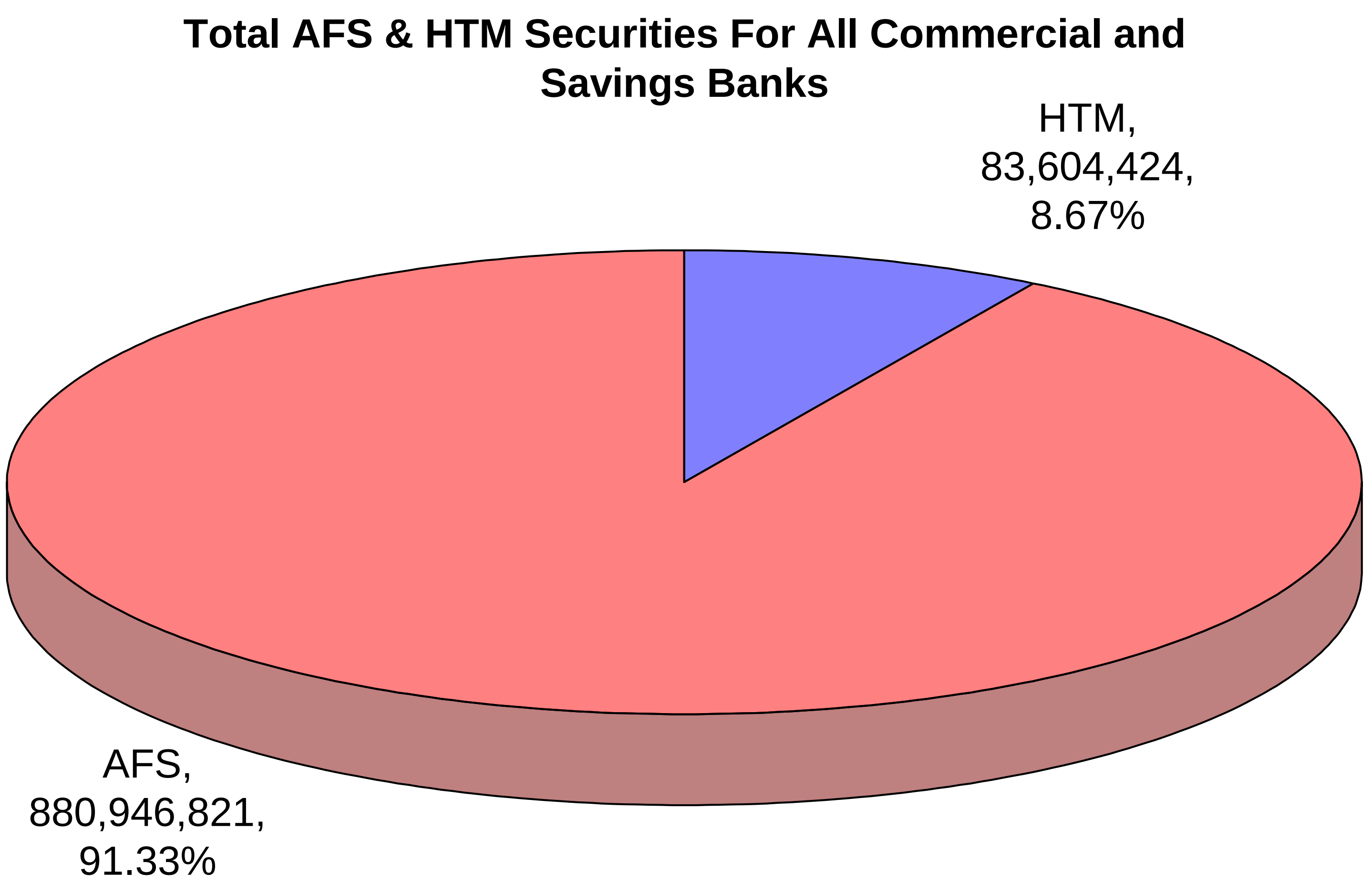
Dot.com Collapse and 9/11 Recession

Bush 43

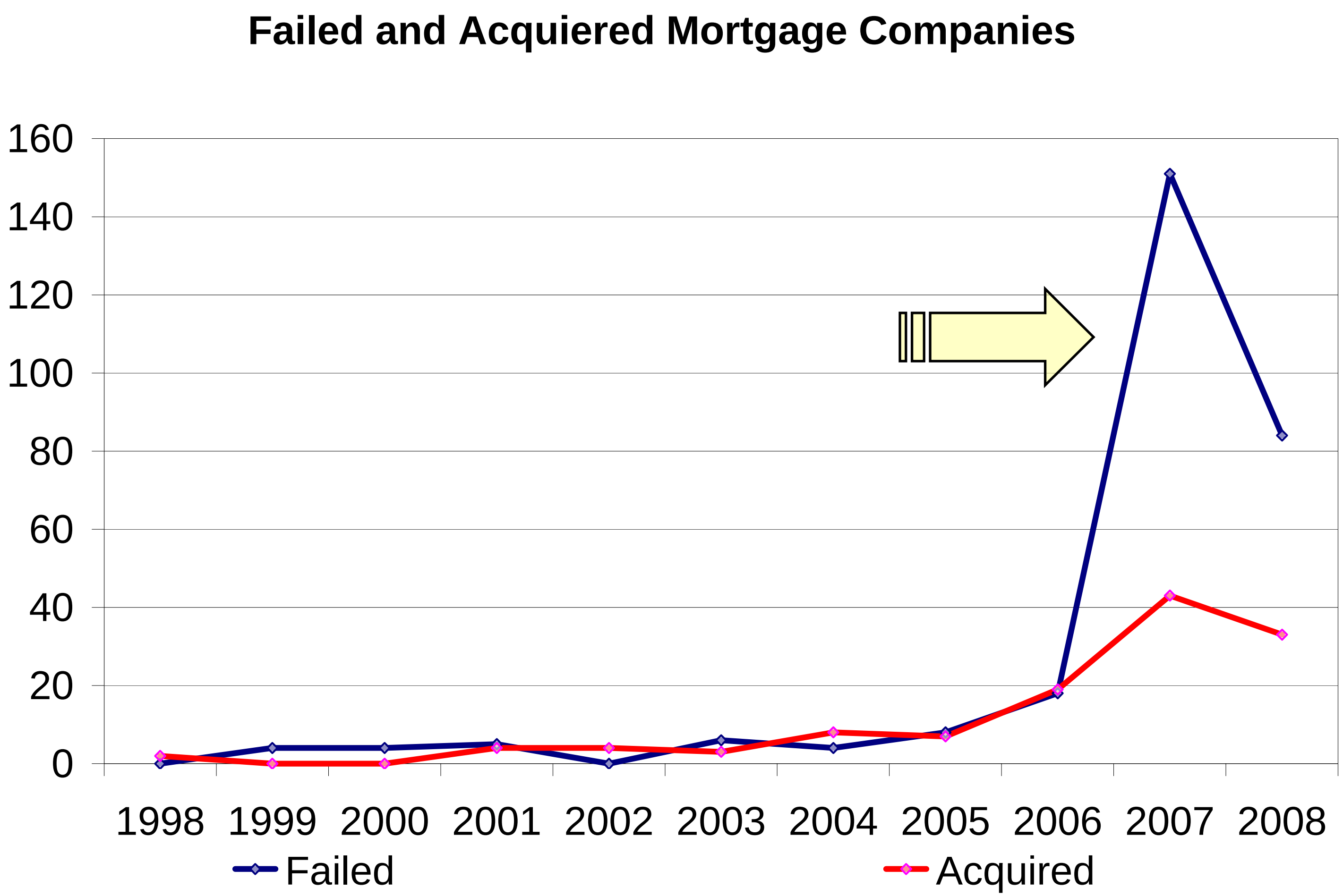
Bush 43

Bush 43

FinPro railed against mark-to-market and pleaded with you to hold securities HTM. We are our own worst enemy!



FinPro projected numerous failures in mortgage banking market . . .



Wall of Shame

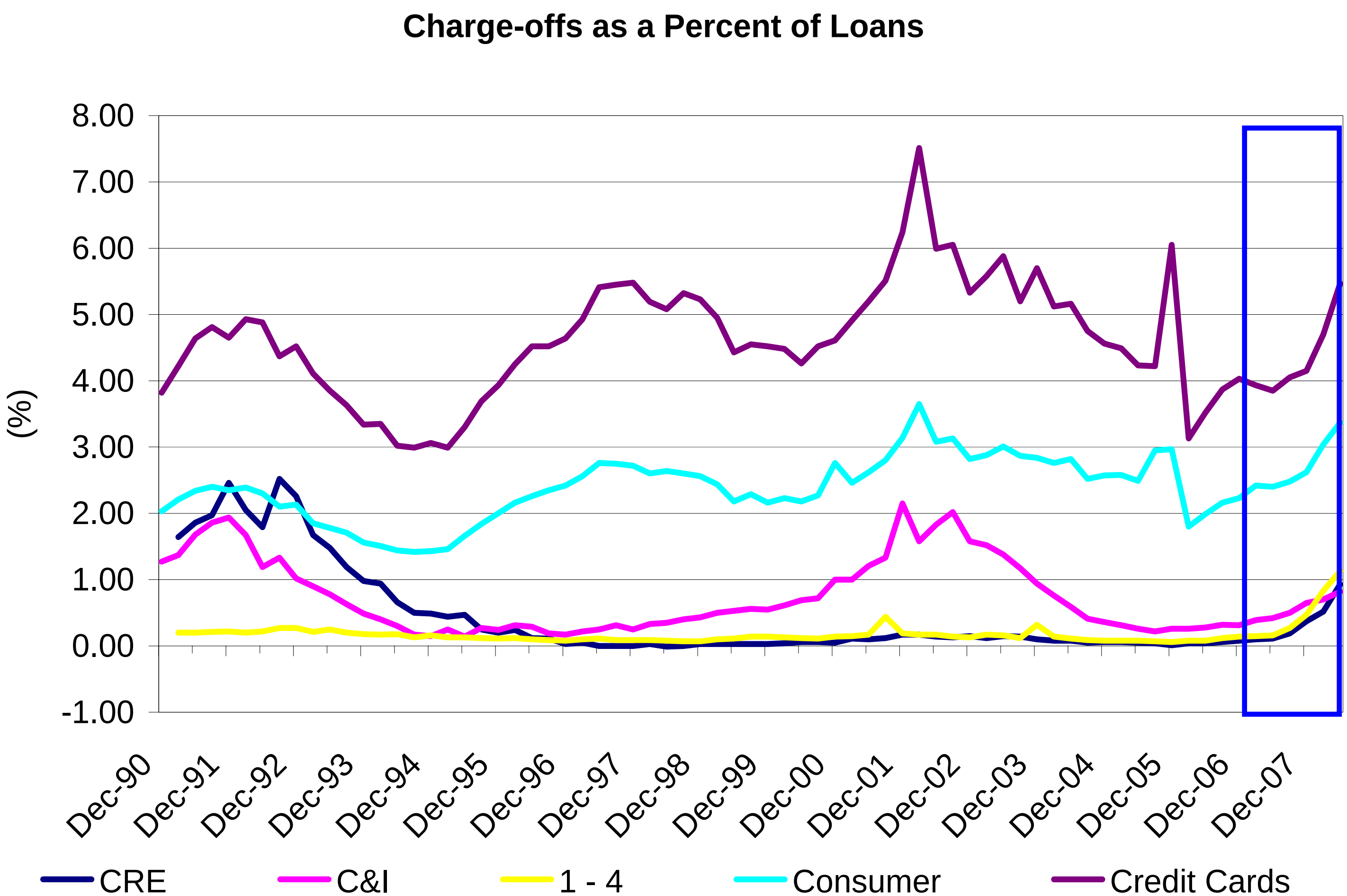
Countrywide

Indymac

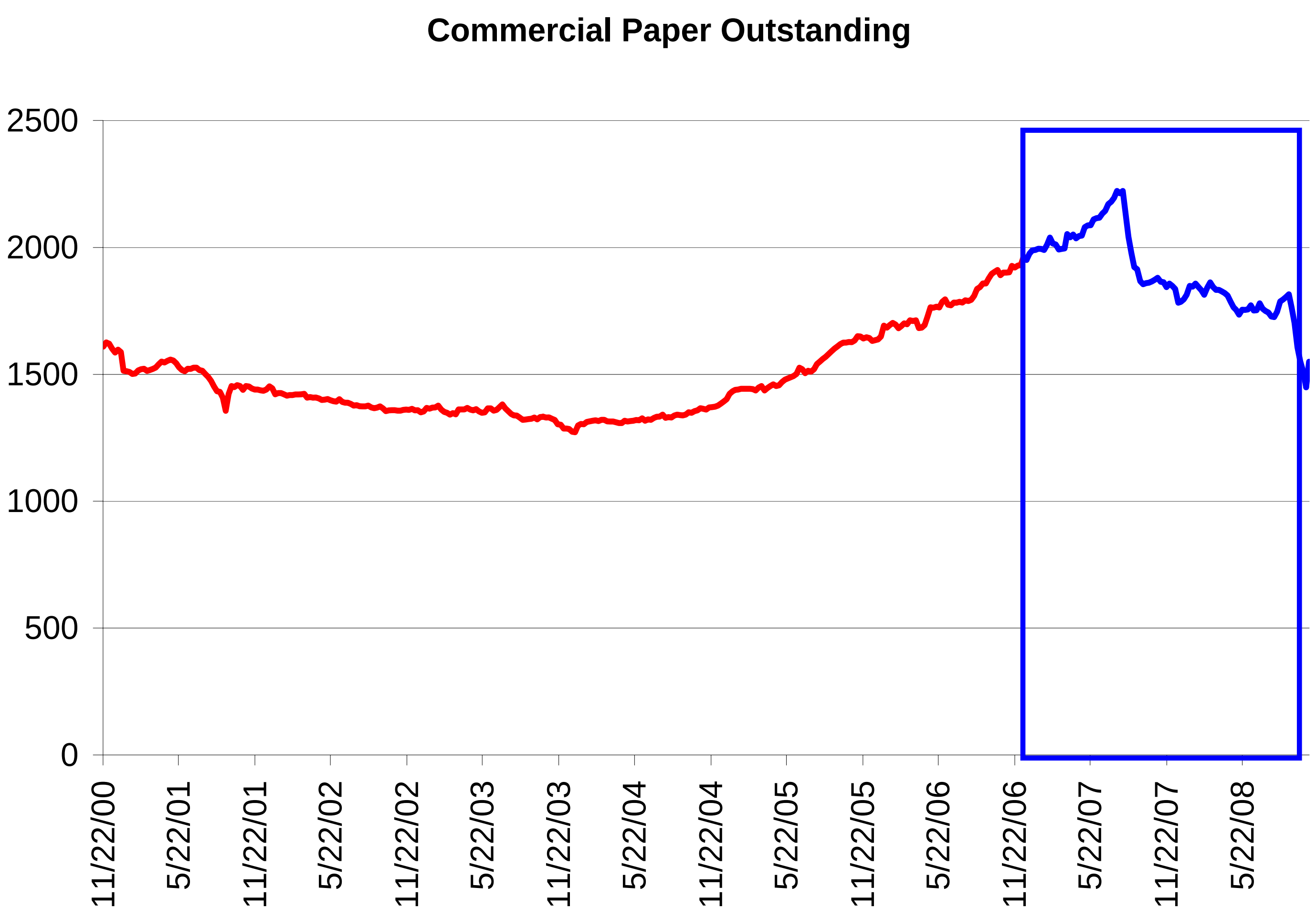
WAMU

Wachovia

And all loan categories saw increases in charge-offs. FinPro cautioned against the CRE thresholds and suggested that the FDIC in particular had the wrong focus . . .



FinPro warned that Corporations might not be able to roll over their debt . . .



So last year, FinPro said Banks should focus on the following . . .

1. Residential mortgage market is up for grabs.
2. Now is the time to restructure staff.
3. Commercial real estate is good, not bad.
4. How do you say “core deposits”?
5. Wall Street is not our friend.
6. Beware the agencies.

We updated our partners throughout the year as follows . . .

- **February 2008** Updated partners about serious issues arising in the investment portfolios, namely FNMA and FHLMC equities and CDOs
- **May 2008** Warned of the rising issues surrounding brokered deposits and borrowings
- **June 2008** Cautioned against collapsing secondary markets
- **September 2008** Warned about Municipals, Corporate Debt and Private Label CMOs. We also warned about FDIC insurance costs and possible FHLB issues.
- **October 1, 2008** Issued out position paper on "Solutions to Economic Doldrums". One week later we issued a position paper on Choices – A solution to the falling real estate problem
- **Today** I add concern about the Government possibly abrogating Master service Agreements on FNMA and FHLMC MBS.

Is it a New World or a Return to the Old World? . . .

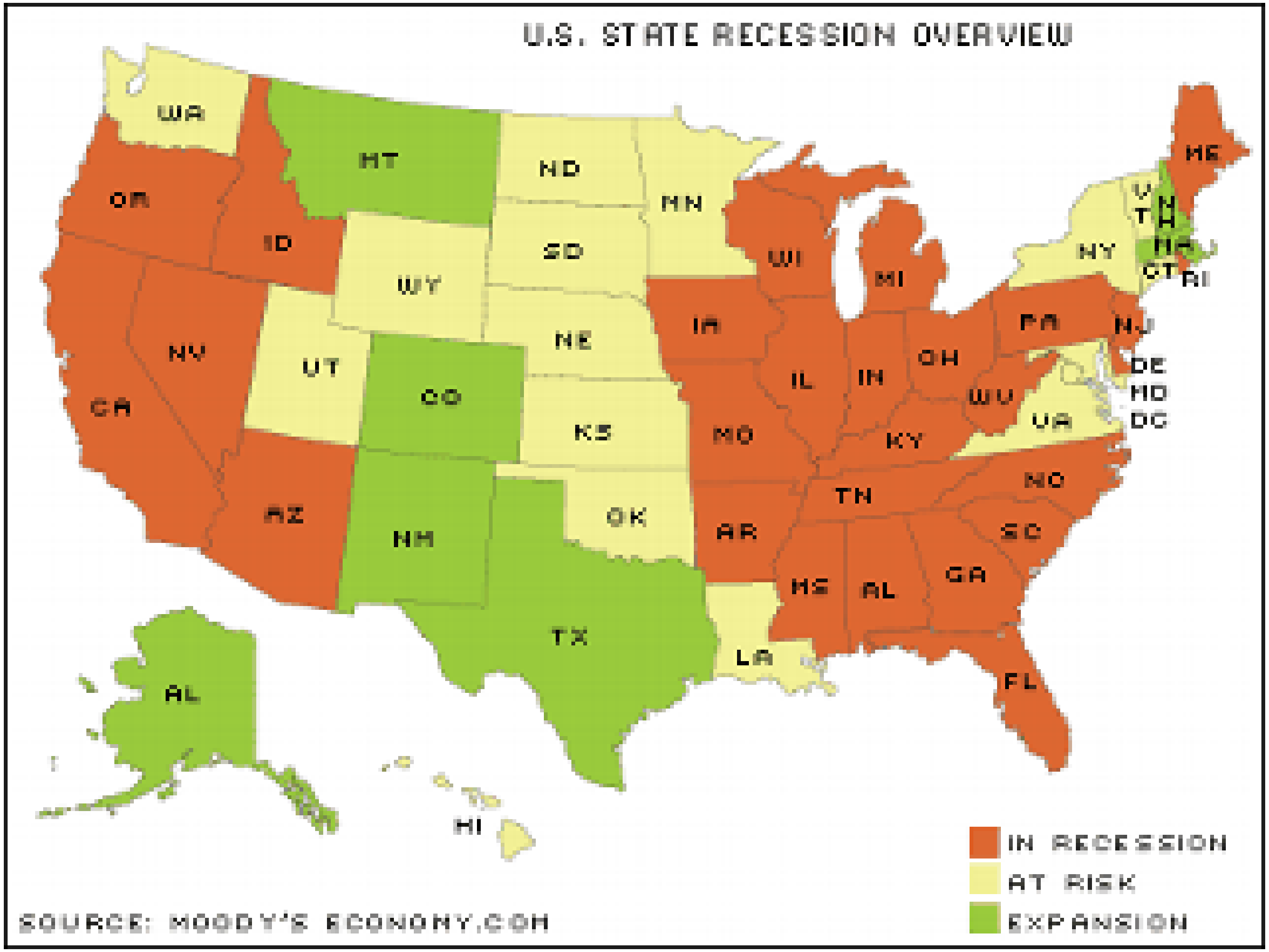
- First, remember that I am one of you
  - Founder and Board Member of Madison National
  - Founder of New Massachusetts Denovo – First Commons Bank
  - Material Investor in 3 others
- I feel your pain but:
- I sense a major opportunity and intend to go after it!

There is no doubt that economic turmoil exists . . .

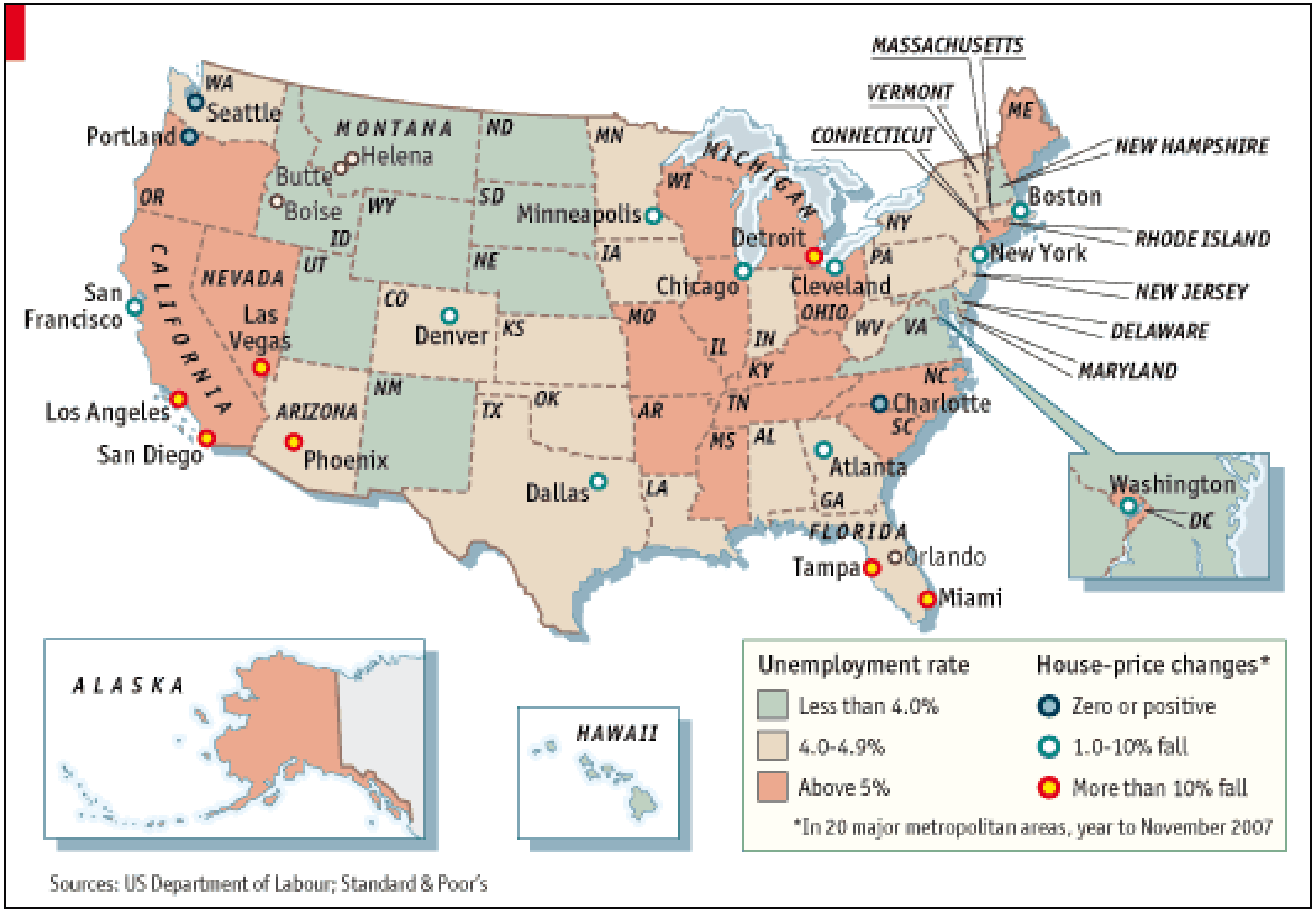
And both parties share the blame

But seriously, for Greenspan to say "the market turmoil is broader than anything I could have imagined", what rock has he been under?

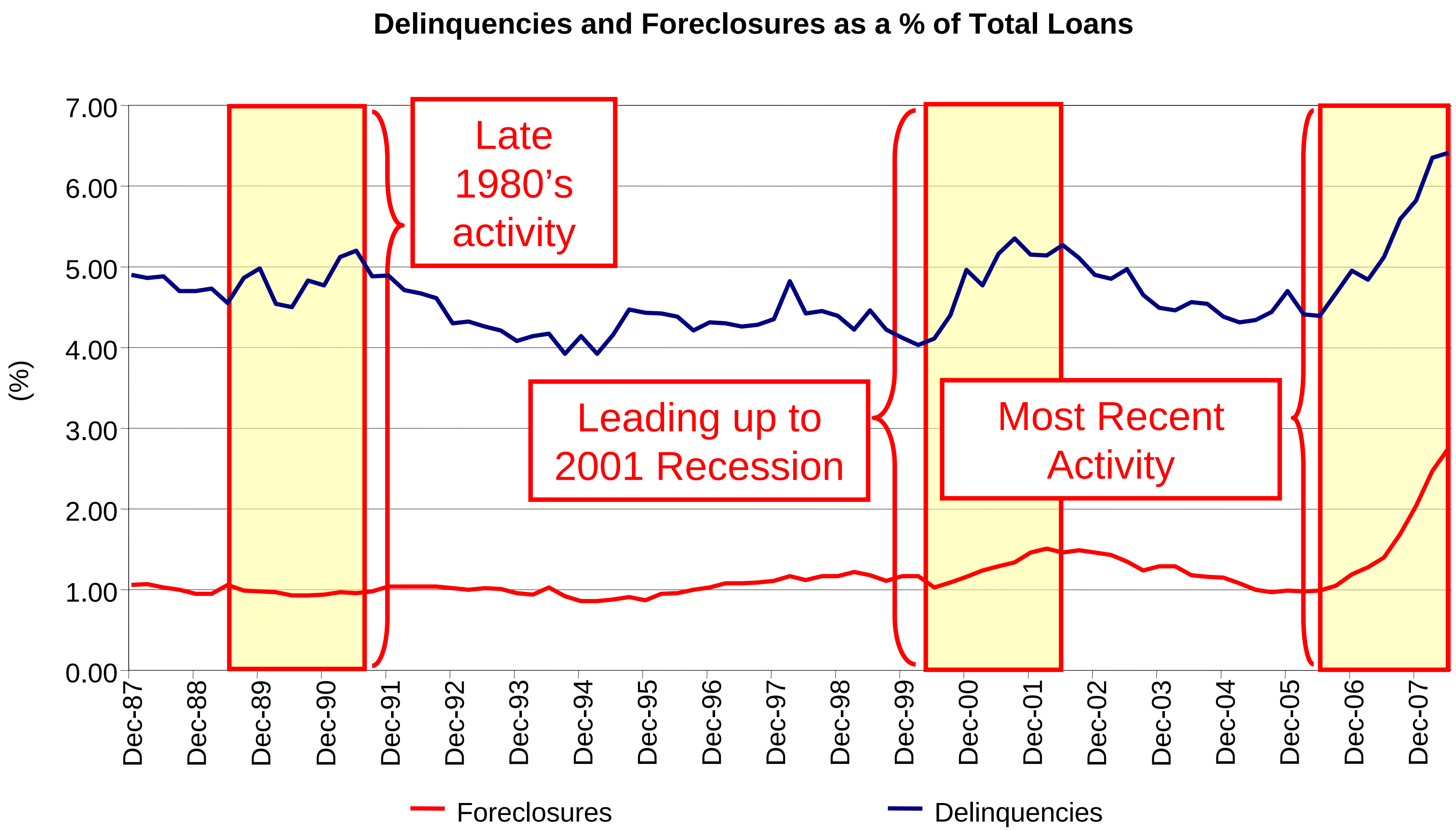
Recession is looming across the entire USA (map as of October 21, 2008) . . .



And unemployment is rising while housing prices are stagnant or in decline . . .



Delinquencies and foreclosures dwarf the last two recession levels . . .



And it is not just a National problem. Under these conditions, who will stay in New Jersey . . .

Population almost 50% greater

A TALE OF TWO STATES

New Jersey		Pennsylvania
	General Facts	
8,724,560	Population	12,440,621
	Tax Facts	
$6,110 (1)	Average Household Property Tax Bill (National Rank)	$2,755 (21)
3	Total State and Federal Tax Burden Rank	20
8.97%	Highest State Income Tax Bracket	3.07%
All pension income, state lottery winnings	Exempt From State Income Tax	Military pensions, state lottery winnings
7.00% (tied for 2nd)	Sales Tax (National Rank)	6.00% (tied for 5th highest)
14.5 cents per gallon (3rd lowest)	Gas Tax (Natinoal Rank)	32.3 cents per gallon (11th highest)
$2.58 per pack (2)	Cigarette Tax (National Rank)	$1.35 cents per pack (21)
12 cents per gallon (26)	Beer Tax (National Rank)	8 cents per gallon
	Budget Facts	
$32.87 billion	General Funding Budget	$28.26 billion
$61.92 billion	Total Spending Including Federal and Misc. Revenues	$48.39 billion
$5,546	Spending Per Capita	$4,977
$30.21 billion (3)	Total State-Tax-Supported Debt (Rank)	$10.82 billion (11)
$3,478 (4)	Per Capita (Rank)	$870 (27)
$2,000	Maximum Property Tax Rebate Check	$650

Smaller Budget AND Spending

So on October 1, 2008 FinPro proposed a roadmap to fix the economic doldrums . . .

Immediate Measures

1. Eliminate mark-to-market accounting
2. Update FDIC Insurance
3. Eliminate conflict of interests with broker/dealers
4. Regulate Private Equity, Hedge Funds and Mortgage Companies
5. Change regulatory perspective
   - Eliminate CRE Thresholds
   - Revisit BASEL II
   - Allowance for loan and lease losses
6. Permanently reinstate the "uptick" rule

Follow up Measures

7. Fix the Real Estate Market
8. Modernize the Regulatory Framework
9. Revisit SOX and GLB
10. All digital transactions must go through the Federal Reserve

And the illustrious brain trust in Washington came up with TARP . . .

- TARP Update
  1. MBS purchase program – In Progress
  2. Whole loan purchase program – In Progress
  3. Insurance program
  4. Capital purchase program – In Progress
  5. Homeowners preservation – In Progress
  6. Executive compensation
  7. Troubled asset auction program – In Progress
- FinPro continues to believe any road to recovery must solve the Real estate crisis. To ignore this is folly.

How will government, TARP and politics impact banks? . . .

- Expect more limitations and intervention
  - Executive compensation
  - Foreclosure
  - Corporate Governance
  - Limits of deal approvals
  - Limits on dividends and repurchases
  - Regulatory reform
  - plus who knows what else

Regulatory reform is coming, like it or not . . .

- Paulson Plan
- The bureaucrats are not going to accept responsibility for this mess, they are looking for someone to blame – witness the Barney Frank Socialist hour
- New regulation for:
  1. Private Equity and Hedge Funds
  2. Credit Unions
  3. Investment Banks
  4. Special Purpose Finance Companies
- This has caused a minor rush to the M&A market by these types of players

What economic projections should banks utilize?

- Banks need to plan under varying economic scenarios
  - Deep Recession – Falling short and stable long term rates
  - Quick Recovery – Falling short rates, holding long rates and then rising rates across curve in late 2009
  - Status Quo – Hold rates constant
- Each scenario has differing assumptions
  - Loan and deposit volume down 20%
  - NPLs, chargeoffs and ALLL increase

How will the banking marketplace change competitively?

- The Wicked Witch is Dead – The death of Wall Street
  - Will all swiftly become “bank like”
  - Deposit competition will stay fierce
  - Complex instruments will decline and Plain vanilla is in
  - Will put “talent?” on the street
- Private Equity Funds looking for bank charters
  - Push for them to be regulated
- In any event, firms that provide investment transactional services should not be allowed to provide independent investment advisory. This is an absolute conflict and is being looked at by Washington.

Will the secondary markets return?

- FinPro believes that there will be a rush to get into the residential lending arena by community banks.
  - The residential secondary market is completely controlled by the government. Will it return to the private or semi private sector?
  - Fears of contract abrogation continue to persist
  - Secondary markets for Auto, multi-family and other loans need a new sponsor.
  - The Bond secondary market will continue to be dominated by the “too big to fail banks” in the long term and by the government in the near term

Will the regulatory environment allow for growth?

- Washington is calling for banks to ”do their job” and lend and grow, yet
- The Regulators don’t want us to grow in CRE, and
- Some charters have other loan type limits, and
- The FDIC doesn’t want us to fund using collateralized borrowings, CDARs and brokered deposits, and
- Competition for funding is increasing due to Federal guarantees, and
- The cost of doing business, namely insurance, continues to escalate

- Sound contradictory – Welcome to Bureaucratic Bungling Banking 101

What will the effect be of the “too big to fail doctrine”?

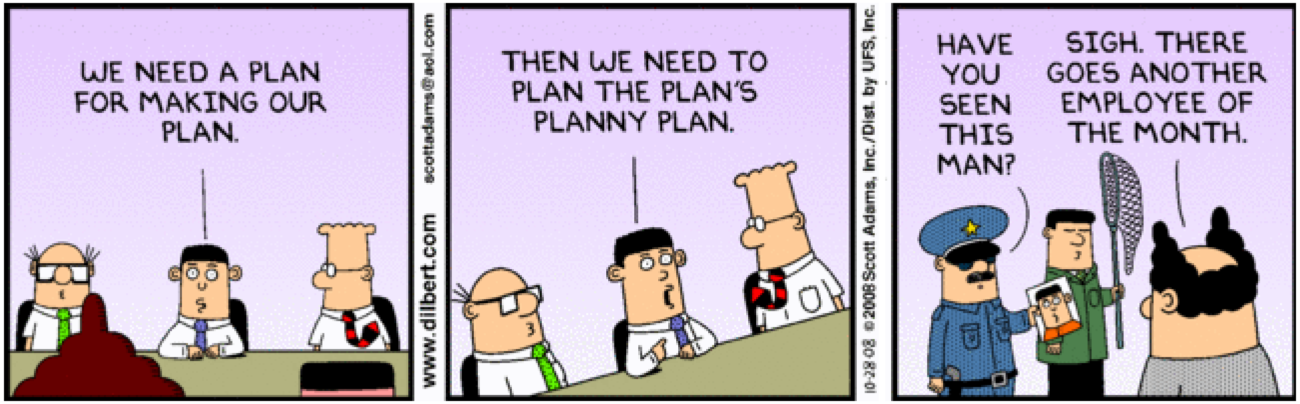
- Competition against “too big to fail banks”
  - Rather than deleveraging, they can now focus on growth and acquisition immediately – good for economy bad for community banks
  - Expect subtle pricing wars
  - Could see dual brands develop – Large banks, small community bank
  - Regulatory attention will go to the privileged few, at the expense of the many
- Will 10% deposit ceiling be changed?
- Evolving Role of Community Banks
  - Makes “no man land even a less popular place to be”

Why are we calling this a Banking Bailout?

- It makes me damn mad!
- By and large, Community Banks are lending, growing and have plenty of capital
- The headline failures have been the Agencies and investment banks. The surviving entities are banks!
- The nomenclature needs to be amended. Its like saying increasing spending is investing in our future. Its close but no cigar!

So building on last year, here are my thoughts on how to proceed in 2009. This is a CALL TO ACTION . . .

- Planning is an ONGOING ACTIVITY, not a yearly event
- Compile a real plan – With focus on execution not airy fairy topics
  - Organic Plan
  - Capital Markets Plan
  - Numerous scenarios with detailed stress testing
  - Plan must focus on execution, not words



CALL TO ACTION, continued . . .

- Prepare for the new balance sheet reality, which is really the old balance sheet reality
  - More loans less investments
    - New concentrations in residential RE
    - Investments will be plain vanilla
  - More core deposits less volatile funding
  - More capital, less leverage
  - Lower fixed assets

CALL TO ACTION, continued . . .

- Some strategies to consider
  - Buy back stock while cheap
  - Steal lending teams from large banks
  - Signature account market
- Plan on significant M&A
  - Could see a few hundred deals quickly
  - Structure yourself now to be a player
- Expect new players
  - Private Equity Funds (witness Chris Flowers)
  - Finance Companies (witness GMAC)
- Expense Control
  - Line by line review
  - Eliminate “nice to haves”

But that presents opportunities . . .

- Obtain market share while "too big to fail" shops are working out problems and eventually digesting deals
- Recapture residential mortgage market
  - Set up Jointly owned Secondary Market and Servicing Operation
  - Plan on this for 50+% of Loan Originations in 2009/2010
- Must also create ATM network that rivals big boys.
- Now is time to aggregate under Multibank Holding Company
  - Consolidate back office expenses
- Its still a people game! To succeed, regardless of size you must upgrade your people.
- This is not going away. The Ostrich Syndrome will kill you.

The future of banking . . .

1. Decline of brick and mortar branches
2. Increase in mobile banking
3. Human branches
4. Advisory, not transactional
5. Digital dollars, less hard currency
6. Barbell banking industry
7. Return of portfolio lending to banks
8. Revised organizational structure
9. “All in One” loan accounts
10. Changing demographics in United States
11. Lack of leadership in banking

So now what . . .

- Our partner, Donald Gibson from Bank of Greene County will present on Organic Growth.
- Our partner, Drayton Alldritt from Equity Bank along with Dennis Gibney from FinPro, will present on Growth by Acquisition.
- Matt Miller of FinPro will present on Sample TARP CPP Methodology.
- Jon Gabriel and Scott Martorana will present on Turmoil Breeds Opportunity.