



SR003_7: Failed Bank Report

Cape Fear Bank

1117 Military Cutoff Road
Wilmington, NC 28405

(6/22/1998 – 4/10/2009)

Report Objective

This report has **two** objectives, using the bank's **data***

1. To examine the bank finances in the quarters prior to its failure.
2. To analyze the bank finances using our Key Performance Indicator (KPI) scoring approach to determine if the bank's failure is something we could have predicted.

*Data source: FDIC and company filings.

Bank Background

FDIC Certificate #	34639
Parent Holding Company	CAPE FEAR BANK CORPORATION
Bank Charter Class	Federal Reserve Non-member
Asset Concentration	Commercial Lending Specialization
Product Specialty	Retail Banking, Mortgage Banking, Business Finance and Merchant Processing Services
Number of Branches	8 (as of March 31, 2009)
Number of Employees	92 (as of March 31, 2009)

Executives	
CEO	Mark Tyler
CFO	Betty V. Norris
COO	Lynn M. Burney

What took place?

Cape Fear Bank, Wilmington, NC was closed by the North Carolina Office of Commissioner of Banks on April 10th, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$131,000,000, compared to the average cost of \$389,206,944. First Federal Savings and Loan of Charleston, SC acquired all deposits and some assets.

Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2008 Q1	2009 Q1	Percentage Change
Assets	\$ 469,950	\$ 492,418	↑ 4.8%
Liabilities	\$ 432,431	\$ 462,786	↑ 7.0%
Net Income	-\$ 303	-\$ 1,851	↓ 511%

- The average net income change for all FDIC banks was -59.6% in the same period.
- The average net income change for all the commercial lending specialization banks was -107.5% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Cape Fear Bank's decline from Net Income is relatively large (-511%) during 2009.

Key Performance Indicators

KPI Summary for 2009 Q1	
Normalized Income Rating	Moderate
Delinquent Asset Rating	Moderate
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Very Poor
Bankability Composite Score	29.04** (Poor)

Possible ratings: *Excellent, Good, Moderate, Poor, Very Poor.*

*This rating is relevant to the current “financial crisis” fueled by mortgage security backed loans.

**This is out of 100.

Normalized Income Analysis

	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Normalized Income	0.04%	-0.06%	-0.07%	-0.79%	-0.14%	-0.38%
SD's from Average*	-0.0393	-0.349	-0.150	-0.887	0.0957	-0.631
Ranking	Moderate	Moderate	Moderate	Moderate	Moderate	Moderate

- Cape Fear Bank had a normalized income of -0.38% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.01%. The standard deviation of the normalized incomes was 0.58%, which means that Cape Fear Bank was 0.631 SD's below the average.

*Average of banks of the same asset concentration hierarchy


Delinquent Asset Analysis

	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Delinquent Asset	0.0634%	0.8590%	0.6408%	1.8960%	3.1958%	2.1695%
SD's from Average*	-0.78	-0.35	-0.41	0.21	0.68	0.11
Ranking	Good	Good	Good	Moderate	Moderate	Moderate



- Cape Fear Bank had a delinquent assets out of total assets ratio 2.17% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.9142%. The standard deviation of the delinquent assets was 2.37%, which means that Cape Fear Bank was about 0.1 SD's above the average.
- Since the fourth quarter of 2007, Cape Fear Bank's delinquent assets ratio has been stable and around the average. From the perspective of delinquent assets ratio, there were no signs of the bank's failure.

*Average of banks of the same asset concentration hierarchy

Real Estate Loan Asset Analysis

	2007Q4 	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Real Estate Loan Asset Ratio	75.70%	75.75%	74.54%	77.25%	78.59%	74.51%
SD from Average*	1.32	1.33	1.21	1.38	1.49	1.27
Ranking	Very Poor	Very Poor	Very Poor	Very Poor	Very Poor	Very Poor


- Cape Fear Bank had a 74.51% of R/A ratio in 09 Q1, the quarter before it failed.
- In 09 Q1, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.23%. The standard deviation of the R/A ratio was 14.37%, which means that Cape Fear Bank was 1.27 SD's above the average.

 * Average of banks of the same asset concentration hierarchy
 Indicates sign of bank in financial distress

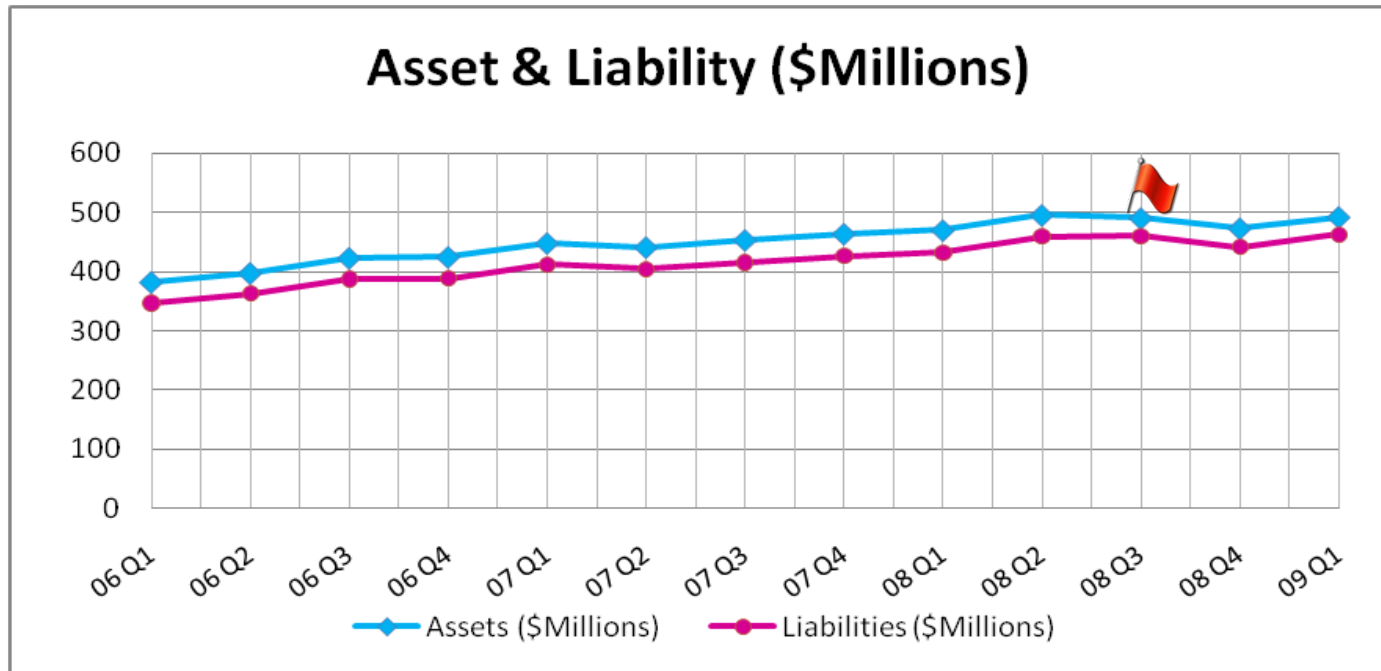
Asset: Liability Analysis

	2007Q4	2008Q1	2008Q2	2008Q3 	2008Q4	2009Q1
Asset: Liability Ratio	108.91%	108.68%	107.94%	106.65%	107.08%	106.40%
Median A/L Ratio*	110.95%	110.93%	110.69%	110.65%	110.52%	110.57%
Ranking	Poor	Poor	Poor	Very Poor	Poor	Very Poor

- Cape Fear Bank experienced decreasing A/L ratio from 07 Q4 to 08 Q3.
- The bank fell into the worst ranking in 08 Q3 and 09 Q1.
- Of the banks failed in Q2 09, 87.50% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in Q1 09, 10.75% failed in the subsequent quarter.

*Average of banks of the same asset concentration hierarchy
 Indicates sign of bank in financial distress

Asset & Liability History

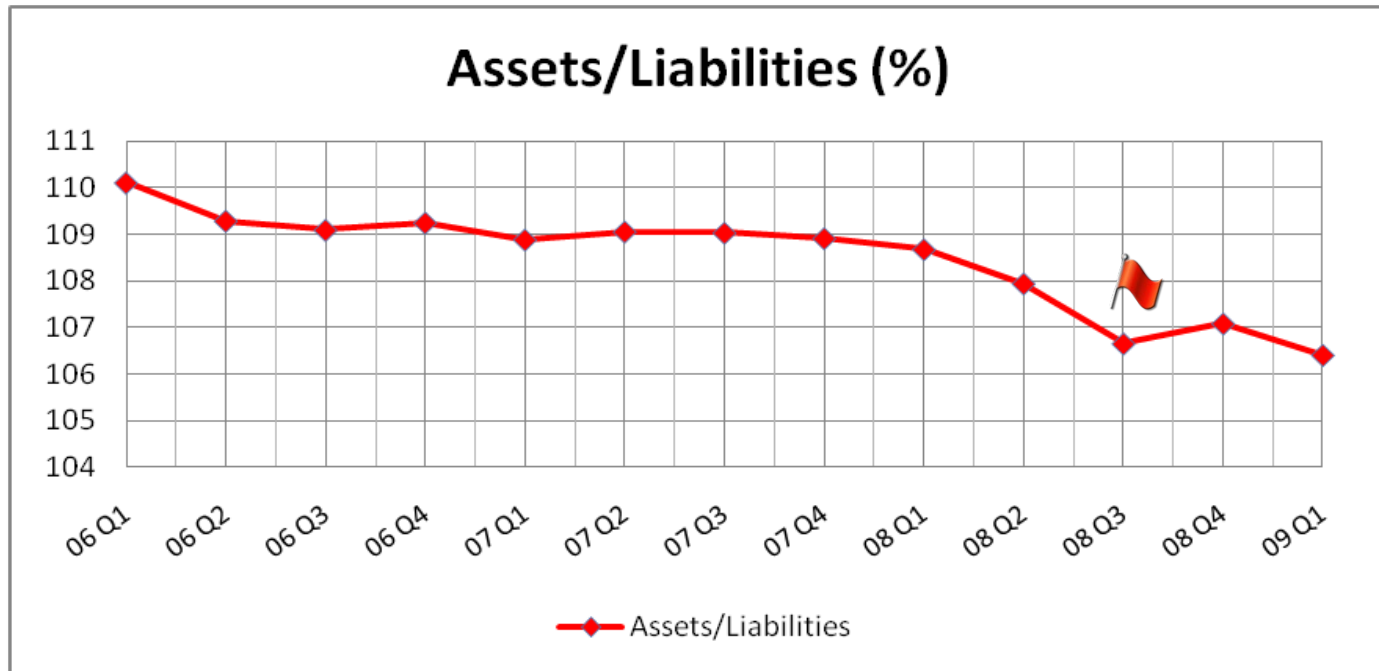


- The difference between asset and liability was consistent in all quarters.




Indicates sign of bank in financial distress

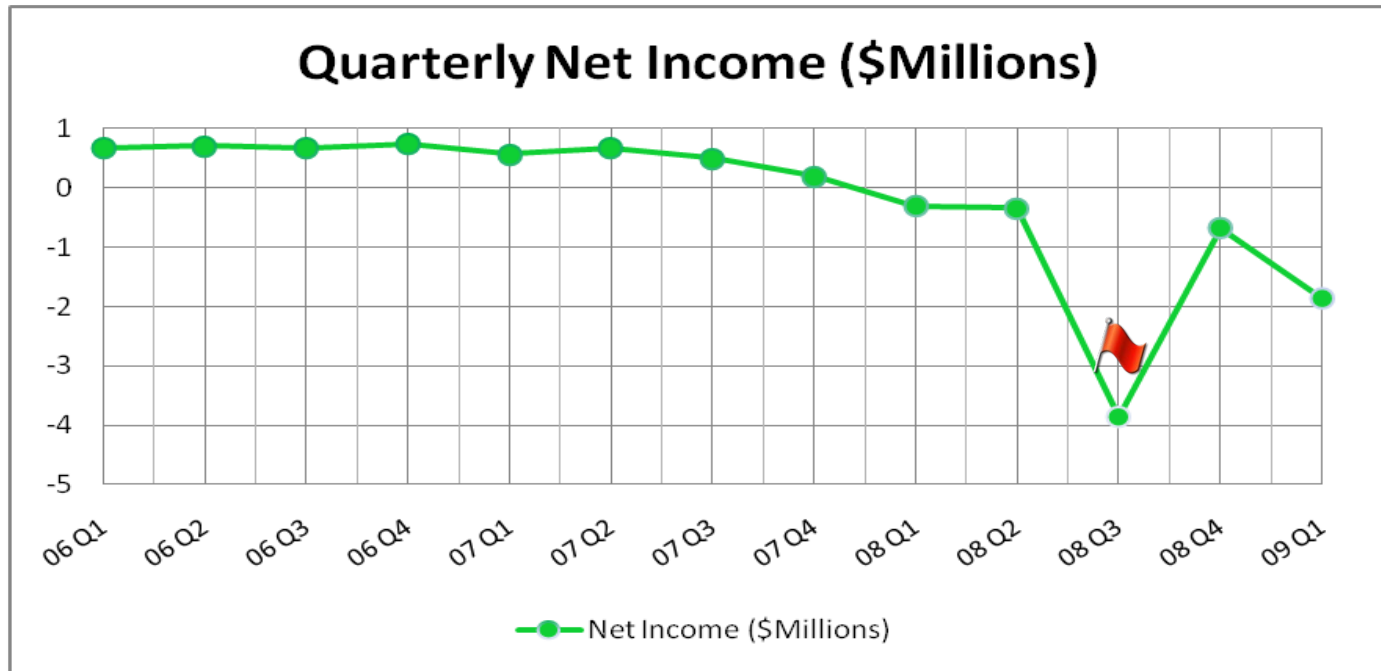
Asset/Liability History



- The A/L ratio was decreasing from 07 Q3 to 08 Q3.

 Indicates sign of bank in financial distress

Net Income History

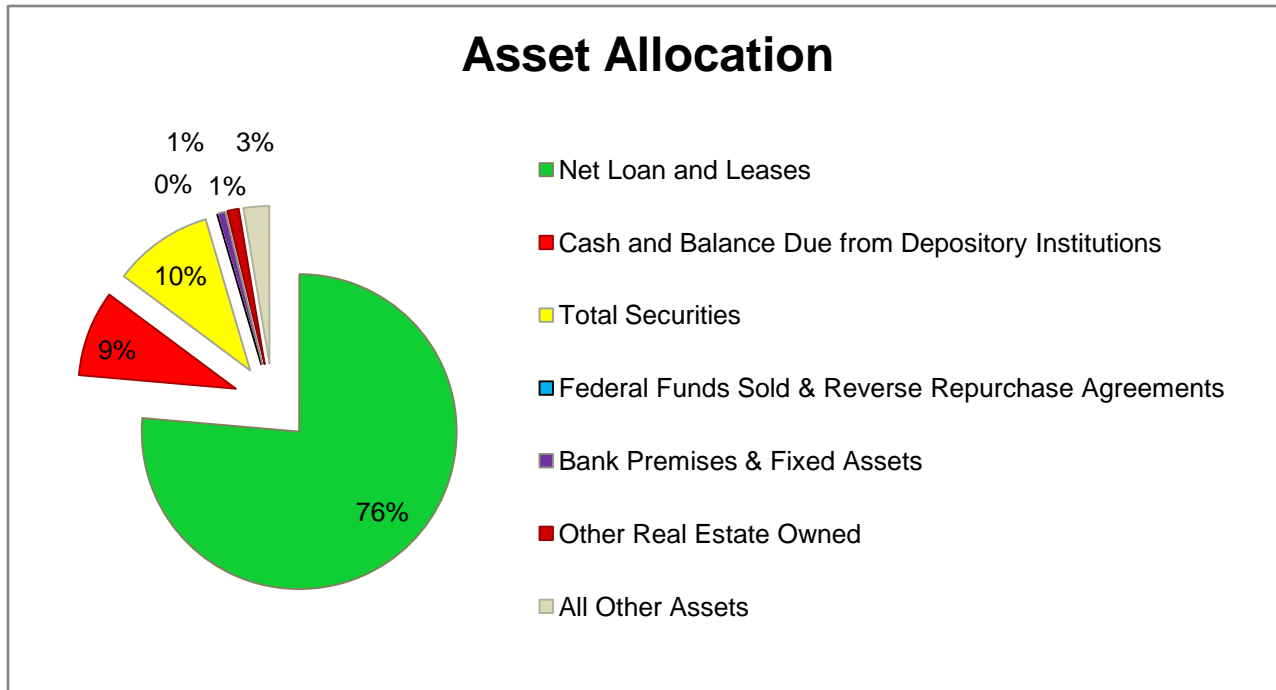


- The bank recorded a big loss in 08 Q3.
- The bank started reporting losses since 08 Q1.



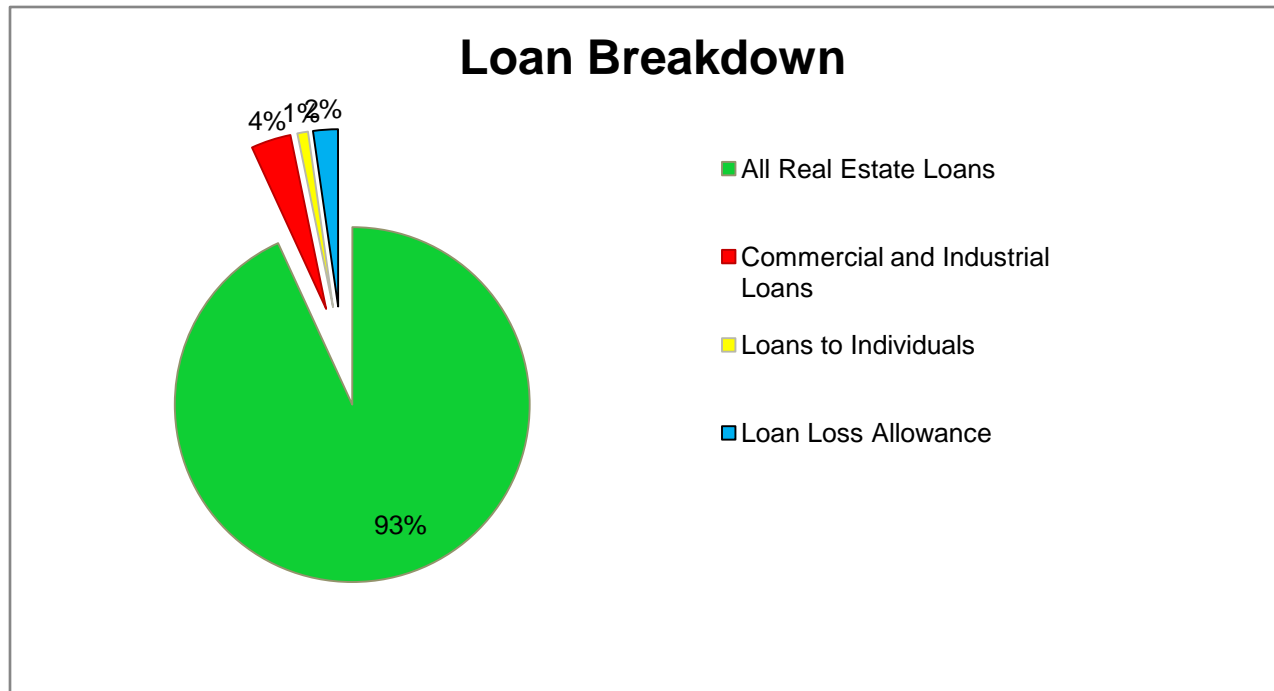
Indicates sign of bank in financial distress

Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in first quarter of 2009 was 71.42%.
- The average Net Loan percentage of all banks in the first quarter of 2009 was 64.89%.

Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2009 was 76.90%.
- The average percentage for all banks in the first quarter of 2009 was 71.75%.

Events Timeline

- Dec. 31, 07** - Shareholders' equity was \$28.5 million.
- Feb. 1, 08** - Cape Fear reported net income for the fiscal year 2007 of \$1.35 million.
- Mar. 4, 08** - SEC voted to disclose information for the secondary market ETF investors in Form N-1A.
- Mar. 7, 08** - The Fed will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion.
- Mar. 19, 08** - Fannie Mae and Freddie Mac is expected to provide support to the U.S. mortgage market, up to \$200 billion immediate liquidity.
- Mar. 27, 08** - Koury, owner of approx 8.7% of the common stock of Cape Fear, notified Cape Fear that he nominated an alternative slate of directors in opposition to the current board of directors.
- Apr. 3, 08** - Cape Fear delayed the filing of its annual report.
- Apr. 25, 08** - Cape Fear reported a net loss of (\$441,000) or (\$0.12) per diluted share for 1Q of 2008.
- May 29, 08** - U.S.-Canada mutual recognition arrangement: U.S. Securities markets and certain U.S. financial service firms could gain greater freedom to operate in Canada under SEC.
- June 10, 08** - FDIC releases a supervisory letter to all banks on interest reserves that examines the risks that this underwriting practice presents.
- June 11, 08** - SEC voted on a comprehensive series of credit rating agency reforms to bring increased transparency to credit rating process.

Events Timeline

- June 17, 08** - New HOPE NOW guidelines to deal with issues surrounding second mortgages and short sales.
- June 26, 08** - FDIC adopts Basel II-Based Standardized Approach as an alternative risk-based capital framework available to all banks except the largest and most complex banks
- June 26, 08** - FRS, FDIC, and OCC issued the host state loan-to-deposit ratios, which help indicate branches outside of the home state that were established or acquired for the purpose of deposit production.
- June 30, 08** - Nonperforming assets totaled \$11.6 million or 2.34% of assets.
- June 30, 08** - Shareholders' equity was \$27 million.
- June 30, 08** - Cape Fear remained at well-capitalized levels with a total risk-based capital ratio of 10.43%.
- Jul. 13, 08** - Paulson Announces a three-part plan for GSEs: a temporary increase in the line of credit, a temporary authority for Treasury to purchase equity, and an advisory role is given to the Fed.
- Aug. 4, 08** - A Net loss of (\$599,000) or (\$0.16) per diluted share for 2Q of 2008.
- Aug. 20, 08** - FDIC's implementation in Loan Modification Program will help to modify troubled IndyMac mortgages loans.
- Aug. 18, 08** - Cape Fear reached an agreement with a group led by investor Koury.
- Aug. 29, 08** - Maurice Koury succeeded in pushing through a restructuring of the board of Cape Fear Bank.

Events Timeline

- Sept. 17, 08** - SEC clarified that bank support of money market mutual funds generally are not required to present the fund on-balance sheet, but disclosure of the nature of the support provided is expected.
- Sept. 18, 08** - SEC requires that certain institutional money managers report their new short sales of certain publicly traded securities.
- Sept. 19, 08** - SEC prohibited short selling in 779 financial institutions.
- Sept. 19, 08** - Cameron Coburn has resigned as President and CEO.
- Sept. 20, 08** - Treasury Secretary Hank Paulson releases \$700 billion proposal to purchase troubled mortgage-related assets.
- Oct. 7, 08** - Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 per Depositor.
- Oct. 14, 08** - FDIC creates new program to guarantee bank debts and fully insure non-interest bearing deposit transaction accounts.
- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.
- Nov. 20, 08** - FDIC announces the availability of IndyMac Loan Modification Model.
- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.
- Dec. 3, 08** - SEC approved measures to strengthen oversight of credit rating agencies.
- Dec. 16, 08** - Troubled banks have to provide certain position level and counterparty level data and QFC counterparty and portfolio identifiers to FDIC in a timely manner.

Events Timeline

- Dec. 23, 08** - Treasury provides TARP funds to focal Banks by purchasing \$2.8 billion investment from 49 banks.
- Dec. 30, 08** - The Fed announced that it will purchase mortgage-backed securities.
- Jan. 15, 09** - The Senate voted to allow access to the remaining bailout funds of \$350 billion.
- Jan. 27, 09** - As part of the Capital Purchase Program, Treasury announced investments of \$386 million in 23 healthy banks.
- Feb. 10, 09** - Geithner rolls out the Financial Stability Plan, promises to perform “stress tests” on big banks, and commit \$100 billion to boost the TALF.
- Feb. 10, 09** - A Capital Assistance Program to help ensure banks hold sufficient capital, produce a more consistent and forward-looking assessment of risks on banks' balance and their potential capital needs.
- Feb. 10, 09** - A Public-Private Investment Fund will combine public and private capital with government financing to help free up capital to support new lending.
- Feb. 10, 09** - Treasury and Fed expended the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 23, 09** - Using TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets.

Events Timeline

- Apr. 10, 09** - Cape Fear Bank was closed by the North Carolina Office of Commissioner of Banks. First Federal Savings and Loan Association of Charleston acquired all of the deposits of Cape Fear.
- May 29, 09** - FDIC tightens the deposit interest rates paid by banks that are less than well capitalized. Generally, such banks will be permitted to offer to "national rate" plus 75 basis points.
- June 9, 09** - 10 Of the largest U.S financial institutions are expected to make CPP repayments to Treasury.
- Jul. 2, 09** - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

Report Summary – *Surprise?*

Based on the methods with which we analyzed Cape Fear Bank, its failure was ***not a surprise.***

Here are the indications that Cape Fear Bank should fail:

- 1) **Cape Fear Bank reported losses since the first quarter of 2008.**
- 2) **Cape Fear Bank reported higher than average delinquent asset percentages the three quarters before it failed.**
- 3) **The bank's asset to liability ratio decreased throughout the quarters prior to failure. It had a 106% ratio the quarter before it failed.**
- 4) **Cape Fear Bank had a bankability composite score of 29.04 the quarter before it failed and 30.03 the quarter before. These scores indicate the bank's poor overall financial health and likelihood to fail.**

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