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Recovery Watch

Q3 2009 Webcast

Real Estate | Economic Outlook | Signs of Recovery



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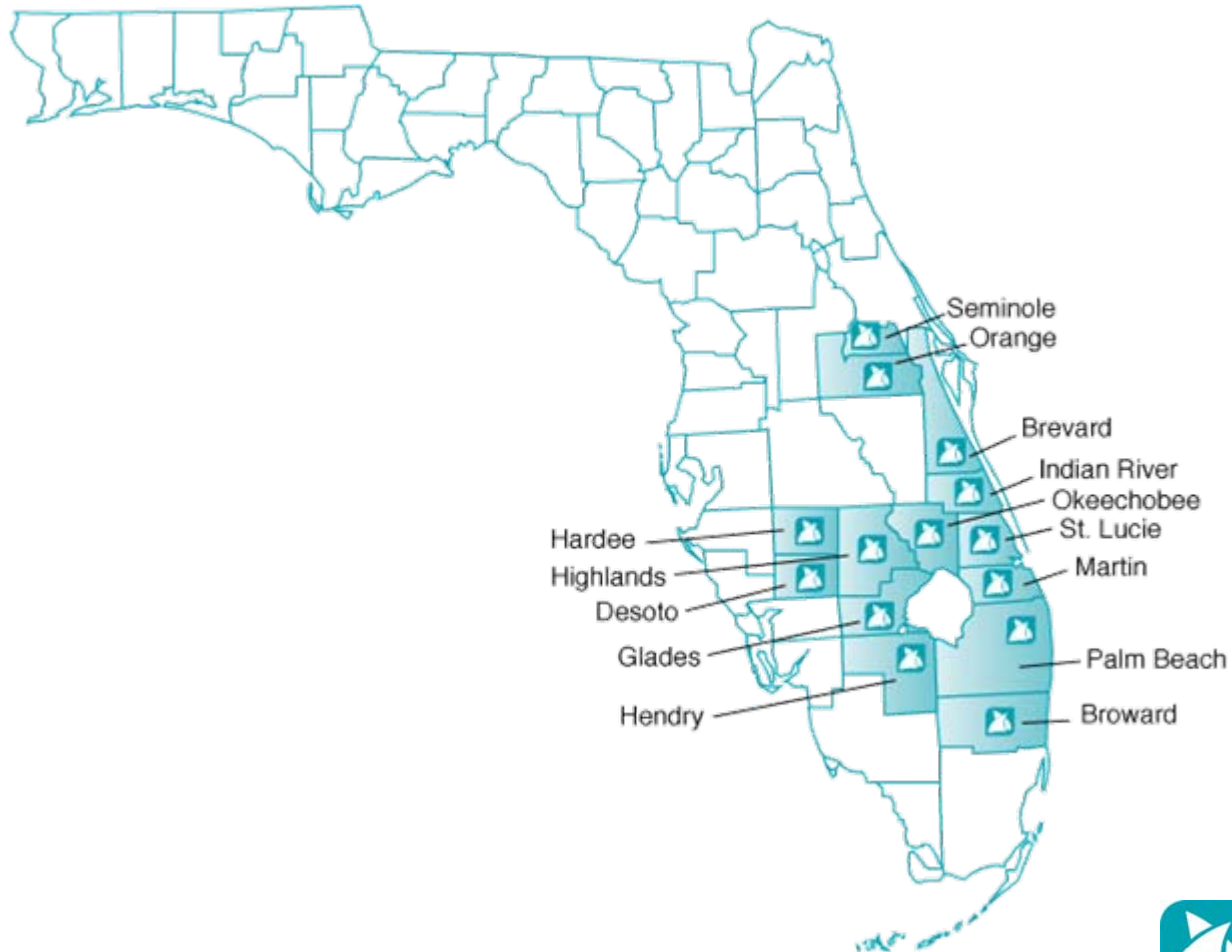
Today's Program

- Economic Highlights
- Real Estate Highlights
- Looking Forward to Recovery



The last three years have been a roller-coaster ride

Seacoast Markets



Ancient Chinese Curse



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“May you live
in interesting
times.”

... and the last three years
have fulfilled the curse.

Is there any good news out there?

- Short answer: **YES**
- Longer answer: Yes, but ...
It is tenuous
It is not consistent
We're still deep in recession.
Risk remains heavily skewed to the downside

Since last fall, with the near collapse of the financial system, we have moved from the edge of Great Depression to a garden variety recession.



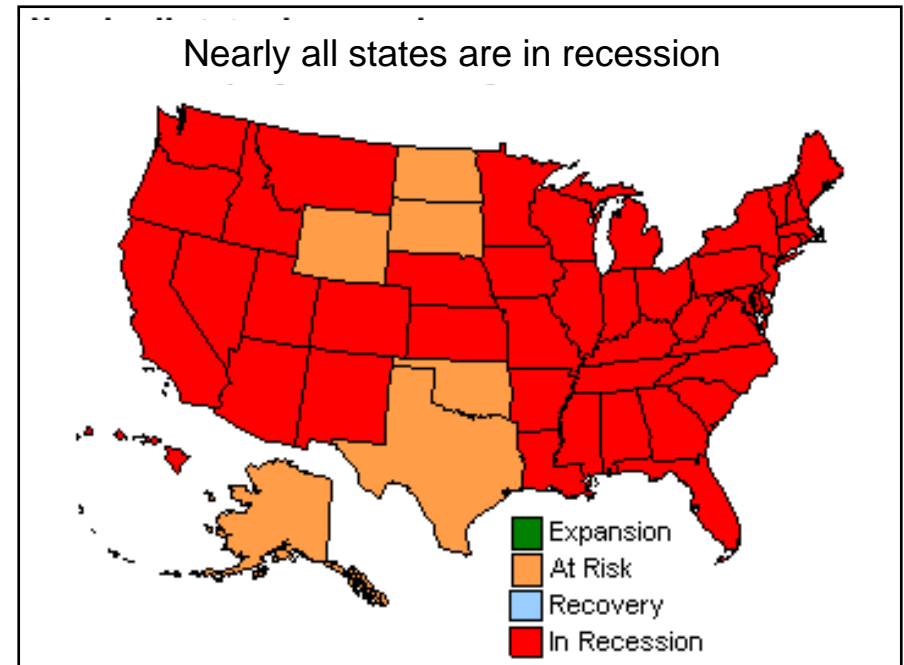
- There are clearly some “green shoots” of new life which we will explore in a few minutes.

Recession Watch

- **The recession is now 21 months old** and clearly the worst (and longest) in decades. Florida may be pushing 30 months.
- **Some industries NOW are seeing the steepest declines since the 1930's.** These include construction, retail professional/business services and financial services.

Recession Watch

- This recession has grown unusually broad and deep. Most recessions since World War II have been at least somewhat regionalized.
- Today, few places to hide with 90% of the nation's 372 metro areas experiencing year-over-year job loss.
- Self reinforcing cycles are at work *nationwide and locally*:
 - Employment
 - Credit availability
 - Foreclosures



Employment Downturn Has Been Extraordinary ... *with structural characteristics*



The nation's unemployment rate of 9.4% (July) is highest in a generation
Florida's unemployment rate of 10.6% (June) is highest since 1976

A disproportionate number of job losses are permanent rather than cyclical.

Unemployed are staying unemployed longer.

More people are working part time for economic reasons.

More people are marginally attached to the labor force.

Work week (paid) has shortened to 33 hours.

More unpaid leave, reduced wages, incentive compensation, etc.

Employment Downturn Intensifies

- July job loss declined to 247,000. Average loss for May through July was 331,000 which is roughly half the average 645,000 job loss in the November
- Current unemployment rates (local and national) understate true level of stress in the job market:
 - The number of *under-employed* workers is rising faster than unemployed. This includes those working part time because full time not available. If all under-employed were counted as unemployed, Florida's unemployment rate would be 15.6%
 - "*Phantom Unemployment*" of independent contractors.
- Self reinforcing unemployment cycle is especially dangerous:
 - Sometimes referred to as negative feedback loop.
 - Unemployment causes consumers to pull back spending which leads to manufacturing pull back which leads to more unemployment and the cycle repeats until broken.
- Problem is exacerbated by deflationary pressure on manufacturers who are forced to reduce prices and ultimately employment.

The Effects of Decelerating Employment

- *The tentacles of decelerating employment reach far and deep.*
- Unemployment is both cause and effect – cycle feeds on and reinforces itself.
- Has led steep decline in spending.
- Has deepened already low confidence.
- Impaired innovation
- Adversely impacted credit quality.
- Has led to more delinquency and mortgage foreclosure
- Adversely impacted the entire economy as evidenced by four consecutive quarters of declining GDP.
- Exacerbate and generally pro-long real estate recovery.

Local Unemployment

Metro Orlando & Space Coast

County	June 2009	May 2009	June 2008
Orange	10.8%	10.3%	5.6%
Seminole	10.2%	9.7%	5.4%
Lake	11.2%	10.8%	6.1%
Osceola	11.4%	11.0%	6.0%
Brevard	10.7%	10.3%	6.2%

SOURCE: Agency for Workforce Innovation

Florida Unemployment = 10.6%

Local Unemployment

The Treasure Coast

County	June 2009	May 2009	June 2008
Indian River	14.1%	13.1%	8.2%
St. Lucie	14.1%	13.4%	8.6%
Martin	11.2%	10.5%	6.8%

SOURCE: Agency for Workforce Innovation

Florida Unemployment = 10.6%

Local Unemployment

The Gold Coast

County	June 2009	May 2009	June 2008
Palm Beach	11.1%	10.4%	6.5%
Broward	9.4%	9.0%	5.3%
Miami-Dade	Not a Seacoast Market		

SOURCE: Agency for Workforce Innovation

Florida Unemployment = 10.6%

Local Unemployment

Big Lake

County	June 2009	May 2009	June 2008
Okeechobee	12.0%	10.8%	7.7%
Glades	10.1%	8.7%	7.2%
Hendry	13.9%	11.7%	10.7%
DeSoto	9.5%	8.6%	6.1%
Highlands	10.4%	9.4%	6.8%
Hardee	10.2%	8.3%	6.3%

SOURCE: Agency for Workforce Innovation

Florida Unemployment = 10.6%

Statewide Employment Trends

- Retail employment will continue to decline as a direct result of decelerating or flat spending.
- Business and professional services as well as financial services (credit-intermediation) will decline coincident with a generally slowing economy, credit distress and decreasing office employment.

Statewide Employment Trends

- Construction losses continue but at a slower pace in the sunbelt (including Florida) but growing elsewhere in the U.S.
- Financial and business service job losses are growing.
- Education and health care continue to grow but at a slower rate.
- Total government grew until December and has now entered the loss column. Government entities are cash strapped.

Employment Trends

- Recent job losses have affected every major demographic (age, gender, race, ethnicity).
- The largest population sector to have been displaced is men over 45 years old. Many of these displaced workers are skilled and will not find work at comparable wages.
- The broader economic fallout from displaced workers
- In Seacoast markets, Palm Beach County and Orlando (Metro) will fare best due to diverse economies. Treasure Coast will fare worst due to construction and real estate driven economy.
- A disproportionate number of workers are working part time for economic reasons.

Inflation / Deflation Prospects

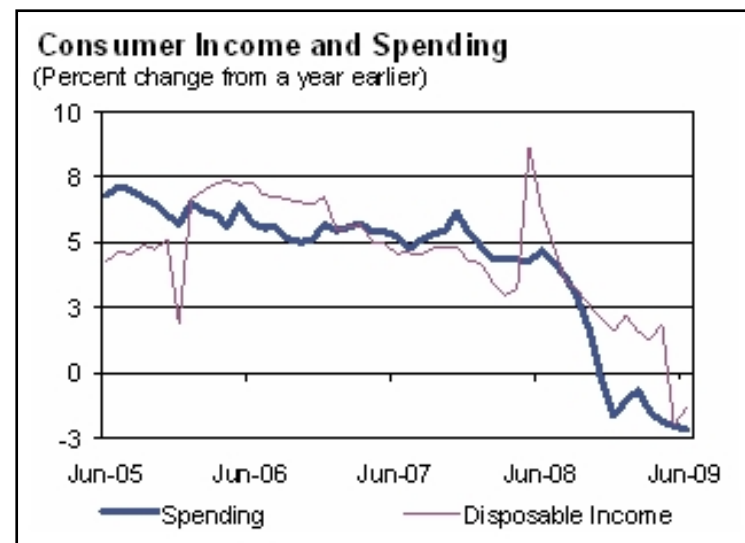
- **Headline inflation** (CPI) increased by 0.2% in July
- The decline has caused some to speculate *deflation* may be in the short term economic future.
- Deflation is an exceedingly hazardous economic condition because consumers tend to hold up purchases expecting prices to decline further (much like they are doing in housing today).
- ***The bigger risk appears to be inflation given the unprecedented number of dollars Treasury is infusing into the economy.***
- The Federal Reserve's balance sheet has ballooned to \$2.2 Trillion from a usually more stable \$995 Billion in government securities.
- The risk (in many areas) is that the Treasury may not be able to withdraw stimulus when the time comes.

Consumer Confidence

- There are three major confidence indices: The Conference Board, University of Michigan and ABC/Reuters.
- Overall consumer confidence slipped again after rising off record lows in May.
- Confidence is being held down as hopes for a quick and strong recovery are held down by the prospect of rising unemployment.
- *Consumer is still struggling with actual or possible job loss, reduced household wealth, tight credit conditions and high debt burden. As the consumer is roughly two-thirds of the economy, the impact is huge.*

Personal Income & Consumption

- Consumer spending rose 0.4% in June – the biggest increase since February. The increase was largely a result of higher gasoline prices (0.5%). Without the gasoline component, spending actually declined in real terms.
- The June decline takes real spending to its cycle low and is down 1.8% from 12 months earlier.
- Stimulus distorted May and June personal income estimates. Without the temporary effect of stimulus, income slipped 0.1% in both months.
- Data revisions show that personal income growth was much weaker this year than previously thought. Income in Q1 dropped 8.3% as compared to previously reported 2.5% decline.
- *Income and consumption numbers do not bode well for a quick or robust recovery.*



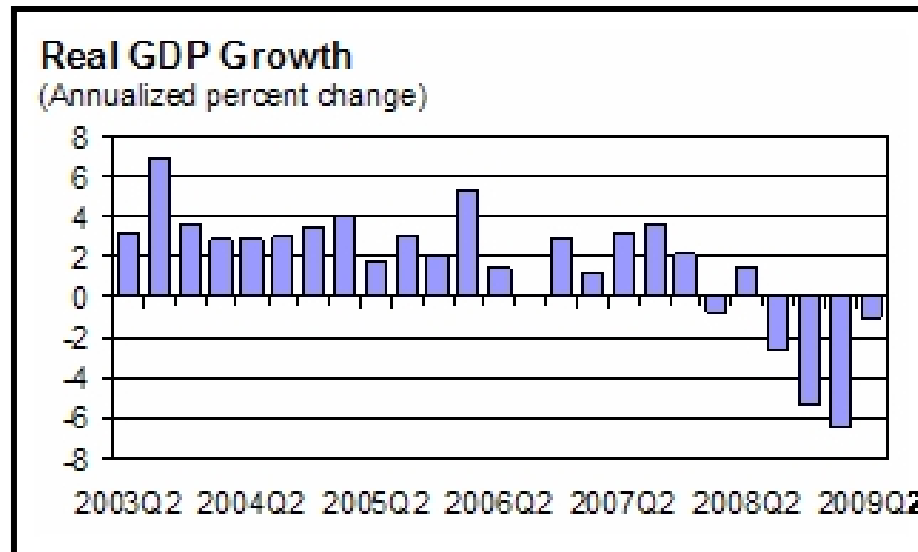
SOURCE: IHS Global Insight

It All Rolls Up to GDP ...

The Gross Domestic Product (GDP) is the top line measure of the economy and the broadest measure of goods and services produced.

Where have we been?

GDP Recent History



SOURCE: Commerce Department Bureau of Economic Analysis | IHS Global Insight

**GDP has contracted for 4 consecutive quarters
and five quarters since 2007.**

GDP Highlights – Q2 2009

- GDP declined at 1.0% in Q2 as compared to negative 6.4% in the first quarter.
- Consumer spending fell 1.2% (quarterly) as compared to modest growth of 0.6% in Q1.
- Savings rate up 5.2%
- Spending on durable goods declined 19.7%
- Spending on durables (consumables) fell 13.1%

GDP Highlights – Q2 2009 -- Business

- Fixed investment declined 60.8% quarter over quarter and 21% year over year. (Components: -30.6% on fixed assets; -20.6% on equipment, and -9.6% on structures.
- Inventories declined 27.2%
- Sales to inventory ratios remain high so inventories could fall some more before turning around.

Housing

Under

Pressure



Residential Markets

- *Price / Value declines worst since Great Depression.*
- Values nearing stabilization. Free fall has stopped.
- Foreclosures are surging and will be with us in some fashion until 2011.
- Secondary market is impaired thereby exacerbating residential financing.
- Pending home sales index rose 3.6% in June – rising for the fifth straight month. That generally bodes well for sales 30-90 days in the future. Recent readings have proven unreliable suggesting a disproportionate amount of contract fallout. Financing and Home Valuation Code of Conduct (HVCC) appear to be the primary suspects.
- *Prices have now generally returned to 2000 - 2003 levels.*

Existing Median Home Prices and Sales Volume June 2009

MSA	June Sales	Change Over May	Median Price	Change Over May
Ft. Pierce PSL	573	+12.13%	\$109,900	No Change
Melbourne Titusville Palm Bay	541	-7.36%	\$117,300	-5.17%
Orlando	2,266	+16.66%	\$149,000	+4.63%
W. Palm Bch Boca Raton	859	+16.55%	\$250,300	+7.4%
Ft. Lauderdale	862	+10.51%	\$204,800	+7.70%
STATE	15,850	+13.86%	\$148,000	+2.49%

National Median: \$181,600 on 4.3MM Transactions

SOURCE: Florida Association of Realtors

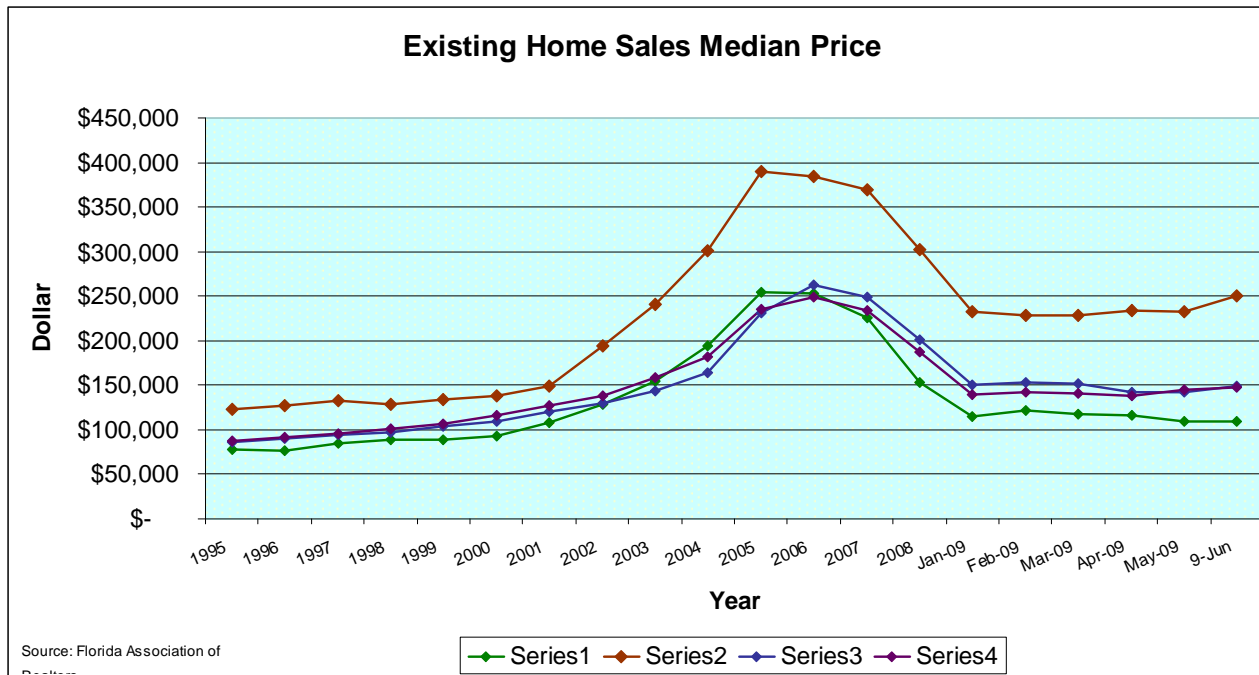


Median Home Price Slide

- Median price decline in Florida since November 2007 peak has been 43%
- Several markets have seen more severe declines. Among Seacoast markets, Port St Lucie declined from \$265,300 at its July 2006 peak to \$109,900 in June 2009 – only three years later. *The median price decline was 58.58%.*
- Let's look at recent trends in Florida and Seacoast markets ...

Existing Home Sales

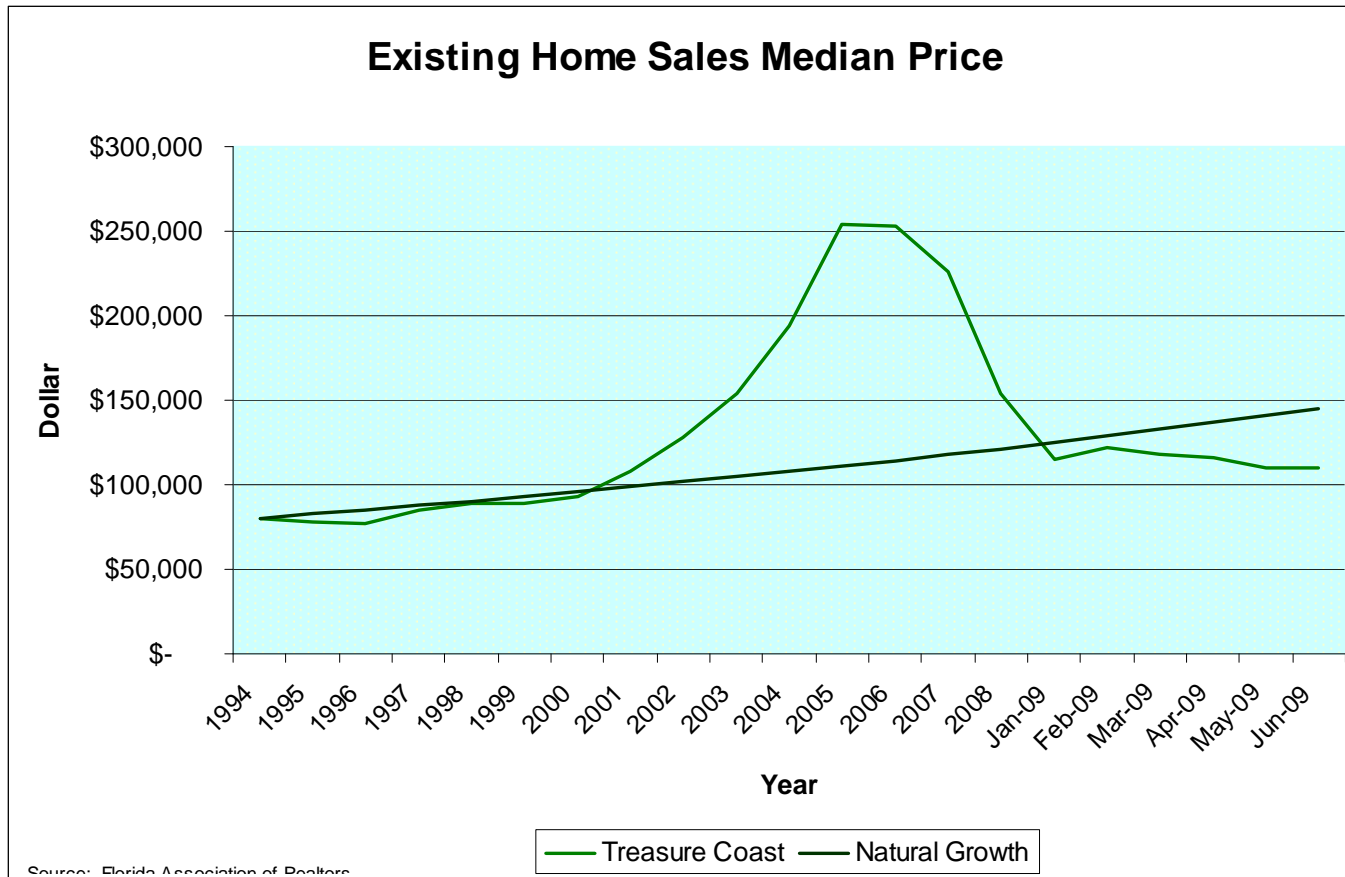
Long Term Median Price Trends



SOURCE: Data Florida Association of Realtors | Analysis Seacoast Economics

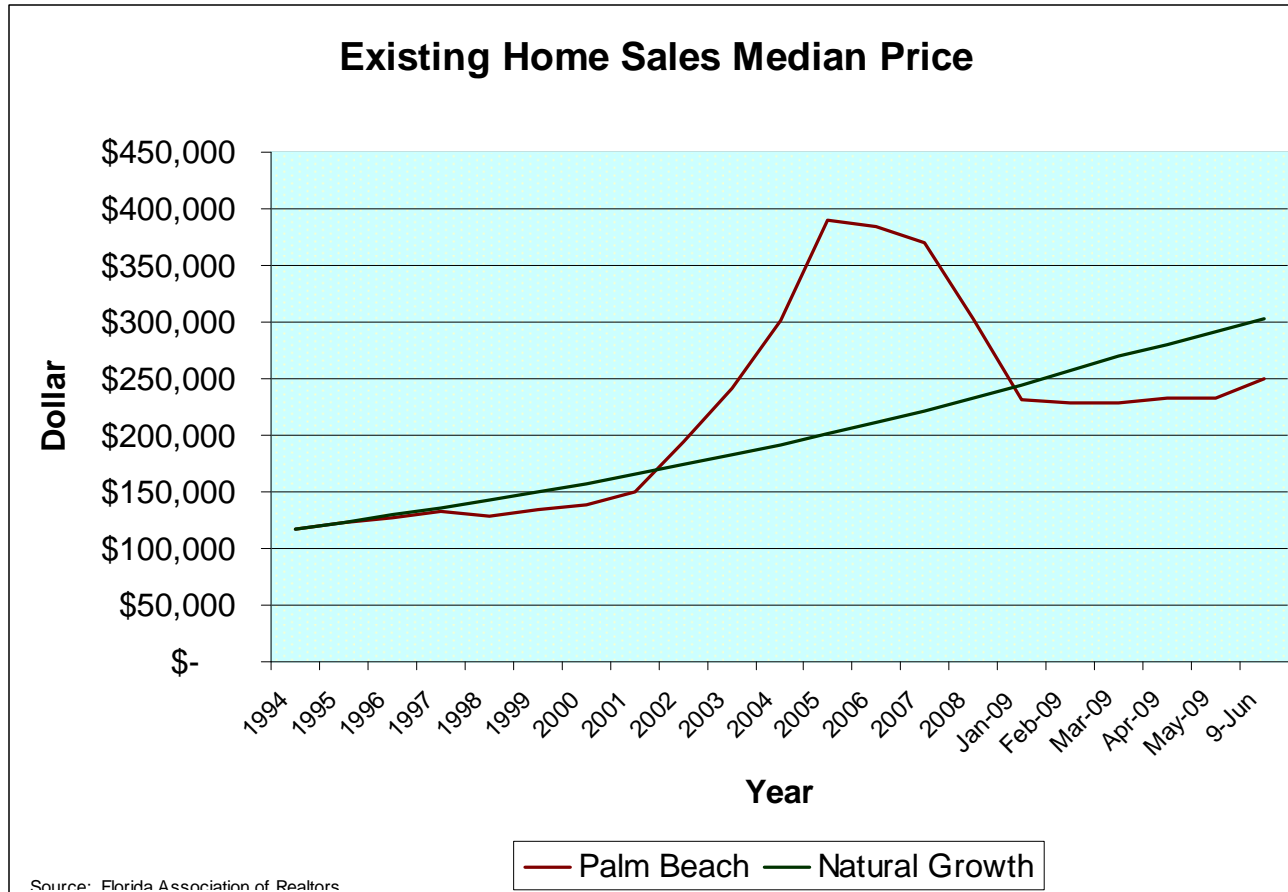
Existing Home Sales

Long Term Median Price Trends

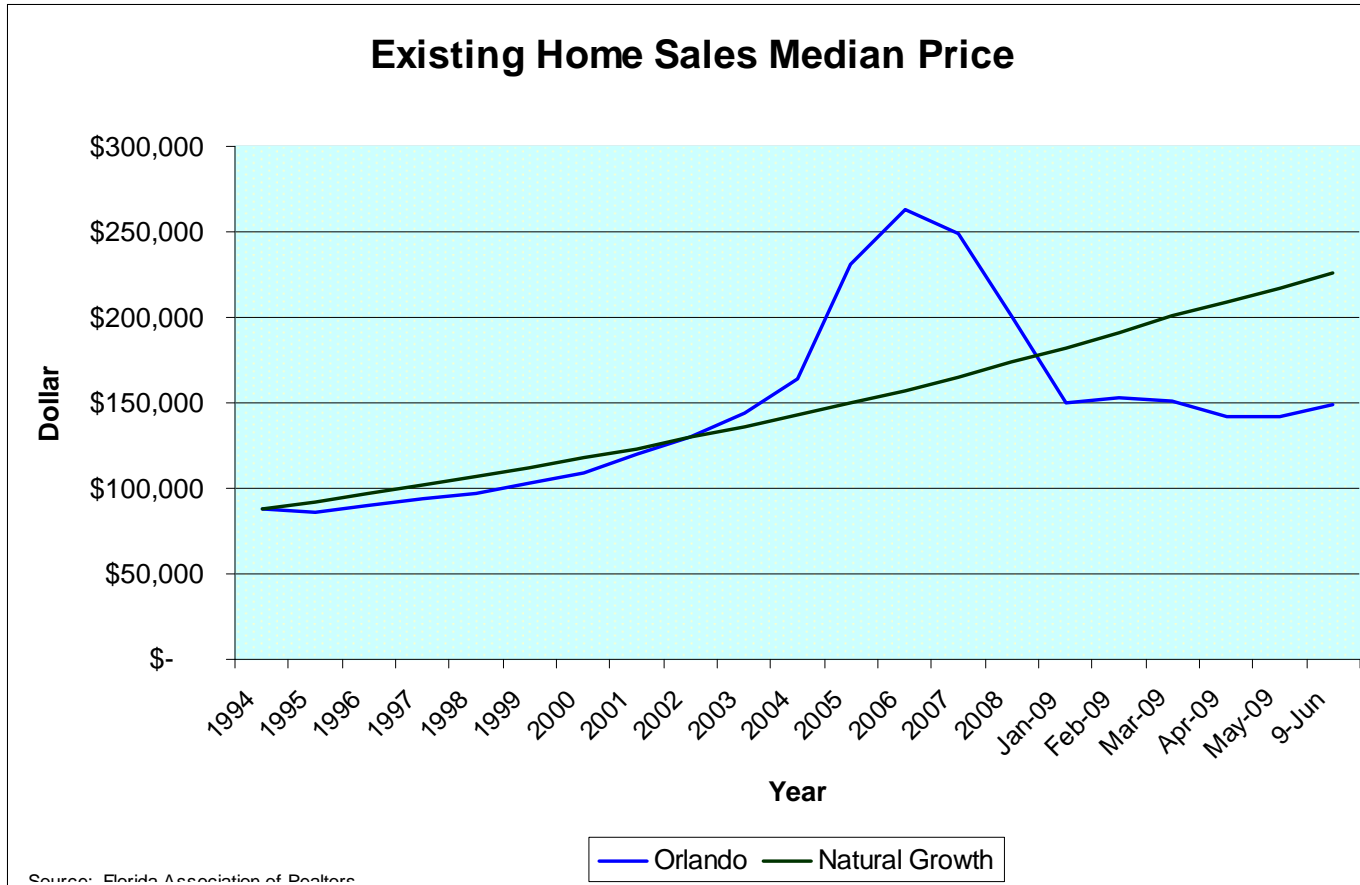


Existing Home Sales

Long Term Median Price Trends

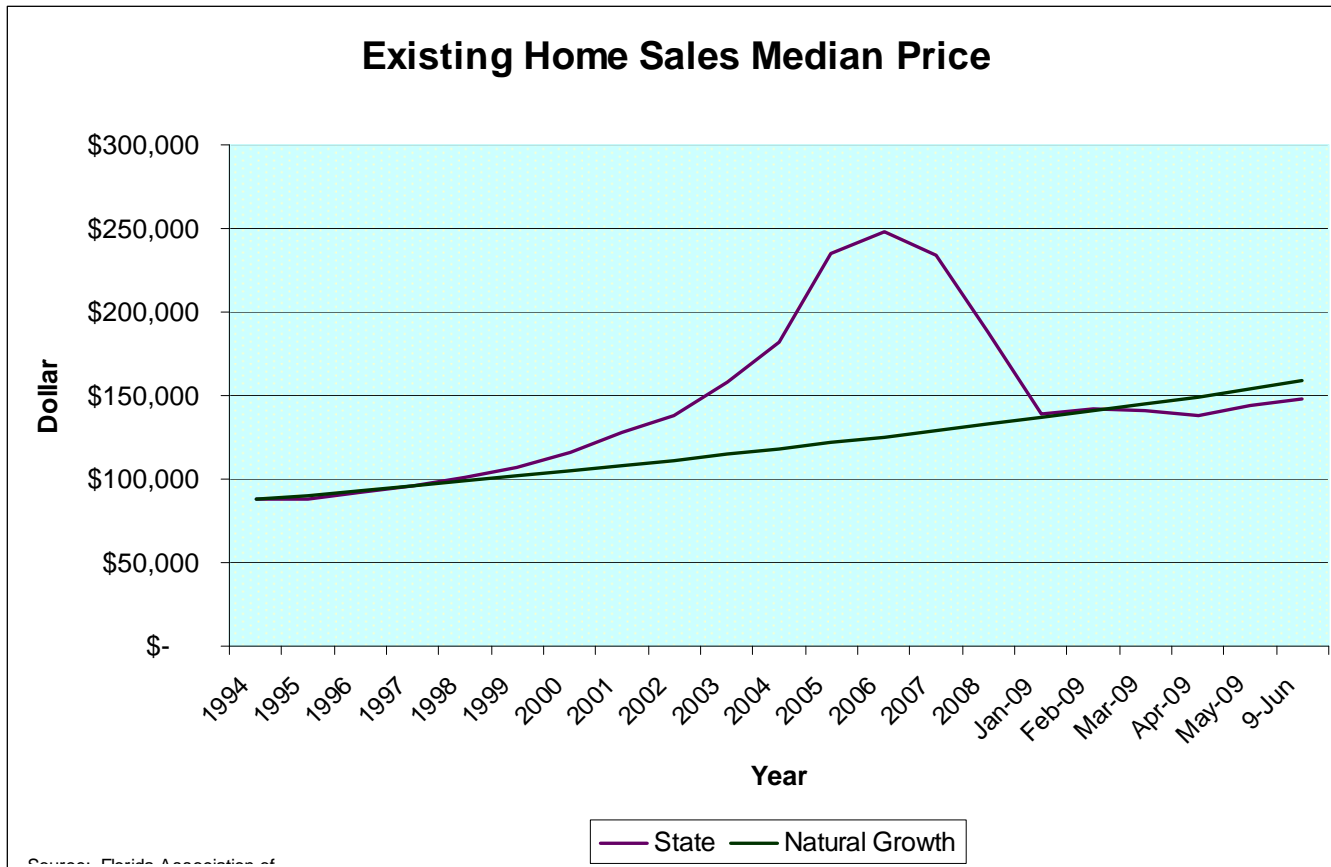


Existing Home Sales Long Term Median Price Trends



Existing Home Sales

Long Term Median Price Trends





New Home Inventory & Sales



New Home Trends

- Existing homes are outselling new homes three to one. Price differential locally is \$50,000 to \$70,000 with new homes still higher.
- New construction starts are at record lows.
- Sales pace is also declining at a rate equal to or slightly greater than the rate of inventory decline.

New Home Inventory & Months of Supply

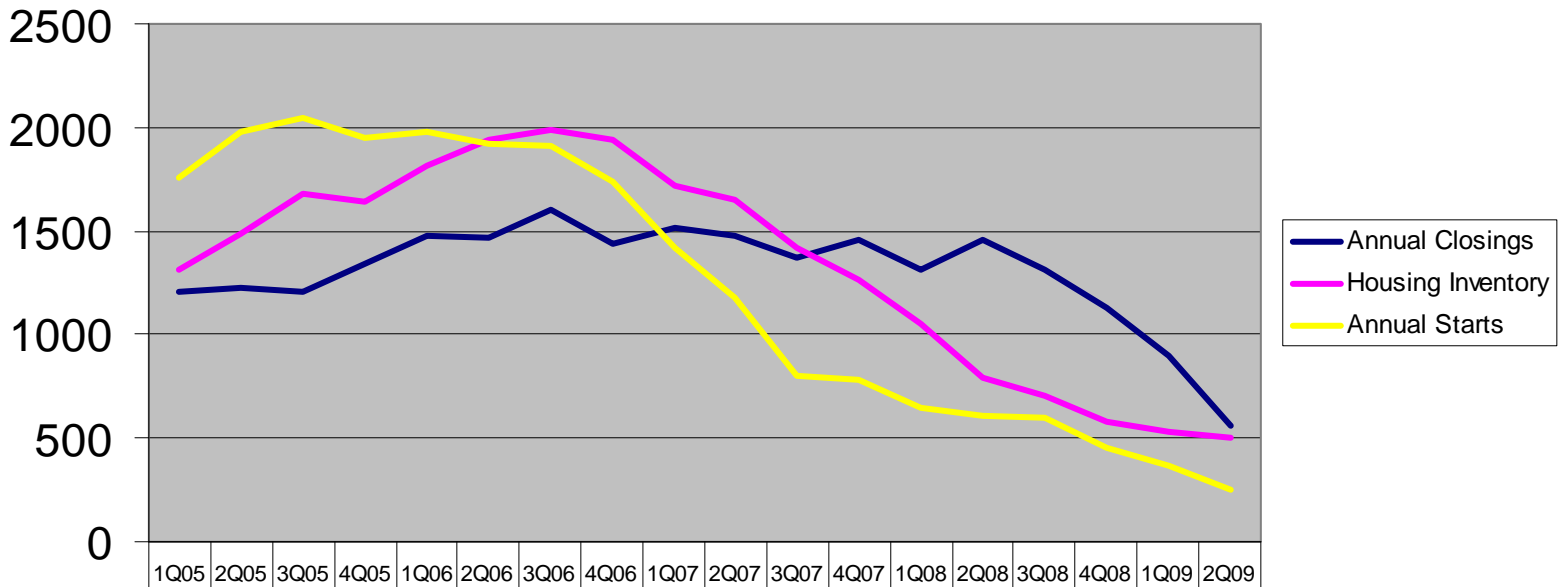
Q2 2009 – Seacoast Core Markets

County	Single Family Inventory	Months Supply
Indian River	501	10.7
St. Lucie	830	16.9
Martin	225	9.9
Palm Beach	1,188	8.5

SOURCE: Metrostudy (Q2 2009) www.metrostudy.com Telephone 561-835-9235

New Construction Trends

Indian River County

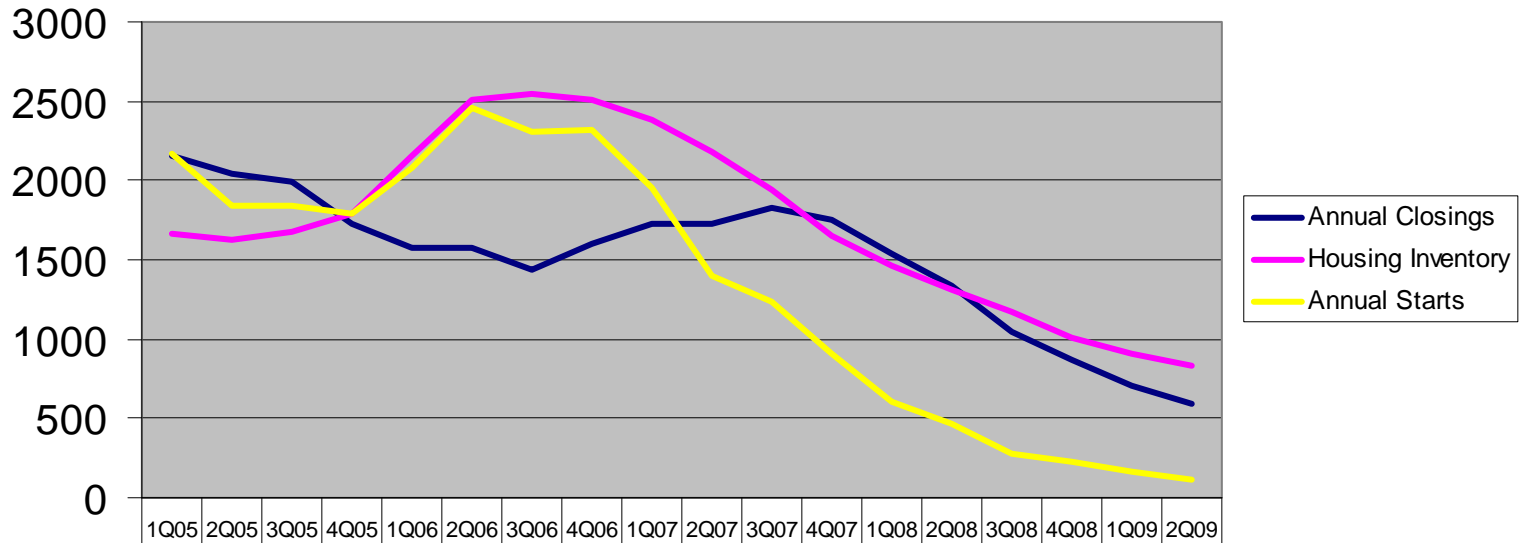


	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Annual Closings	1209	1228	1203	1345	1474	1466	1606	1437	1515	1479	1374	1461	1309	1459	1309	1134	894	561
Housing Inventory	1310	1485	1676	1644	1813	1943	1986	1944	1717	1646	1416	1262	1055	793	702	581	530	501
Annual Starts	1757	1980	2047	1947	1977	1924	1916	1737	1419	1182	804	779	647	606	595	453	362	254

Data Source: Metrostudy

New Construction Trends

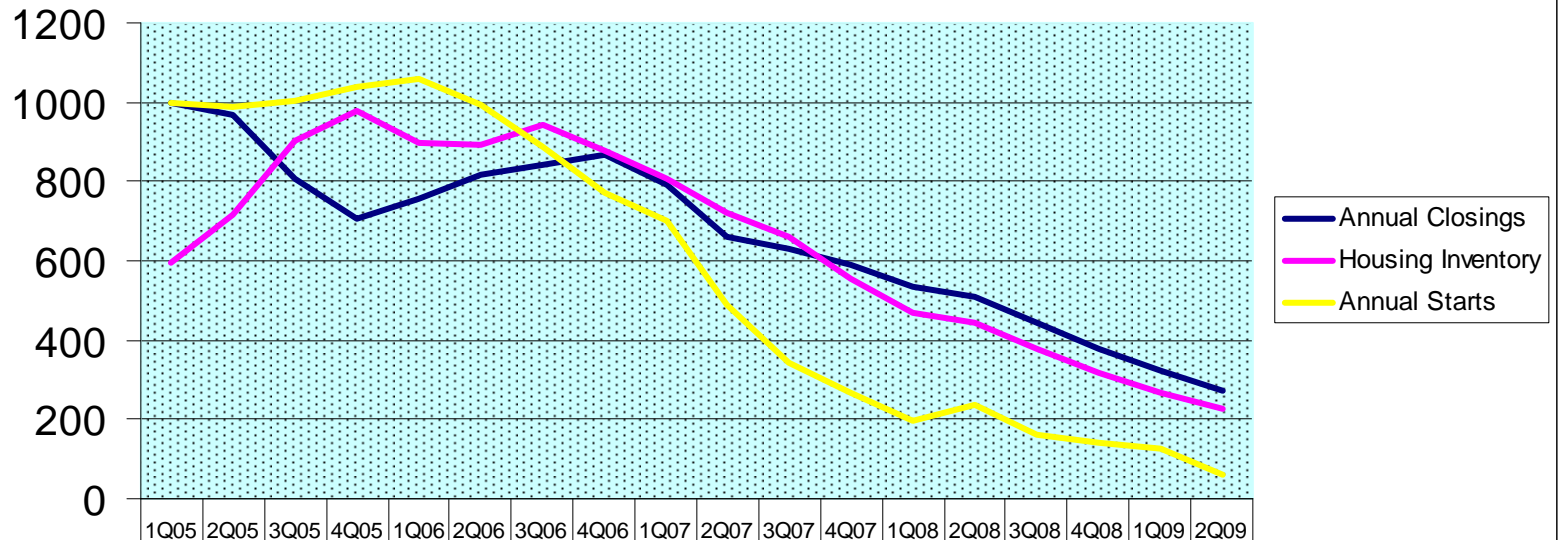
St Lucie County



	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Annual Closings	2161	2047	1995	1728	1581	1579	1432	1599	1732	1721	1828	1756	1535	1335	1052	871	709	589
Housing Inventory	1662	1628	1674	1791	2161	2505	2543	2511	2384	2178	1945	1657	1459	1308	1169	1007	907	830
Annual Starts	2163	1837	1839	1793	2080	2456	2301	2319	1955	1394	1230	902	610	465	276	221	158	112

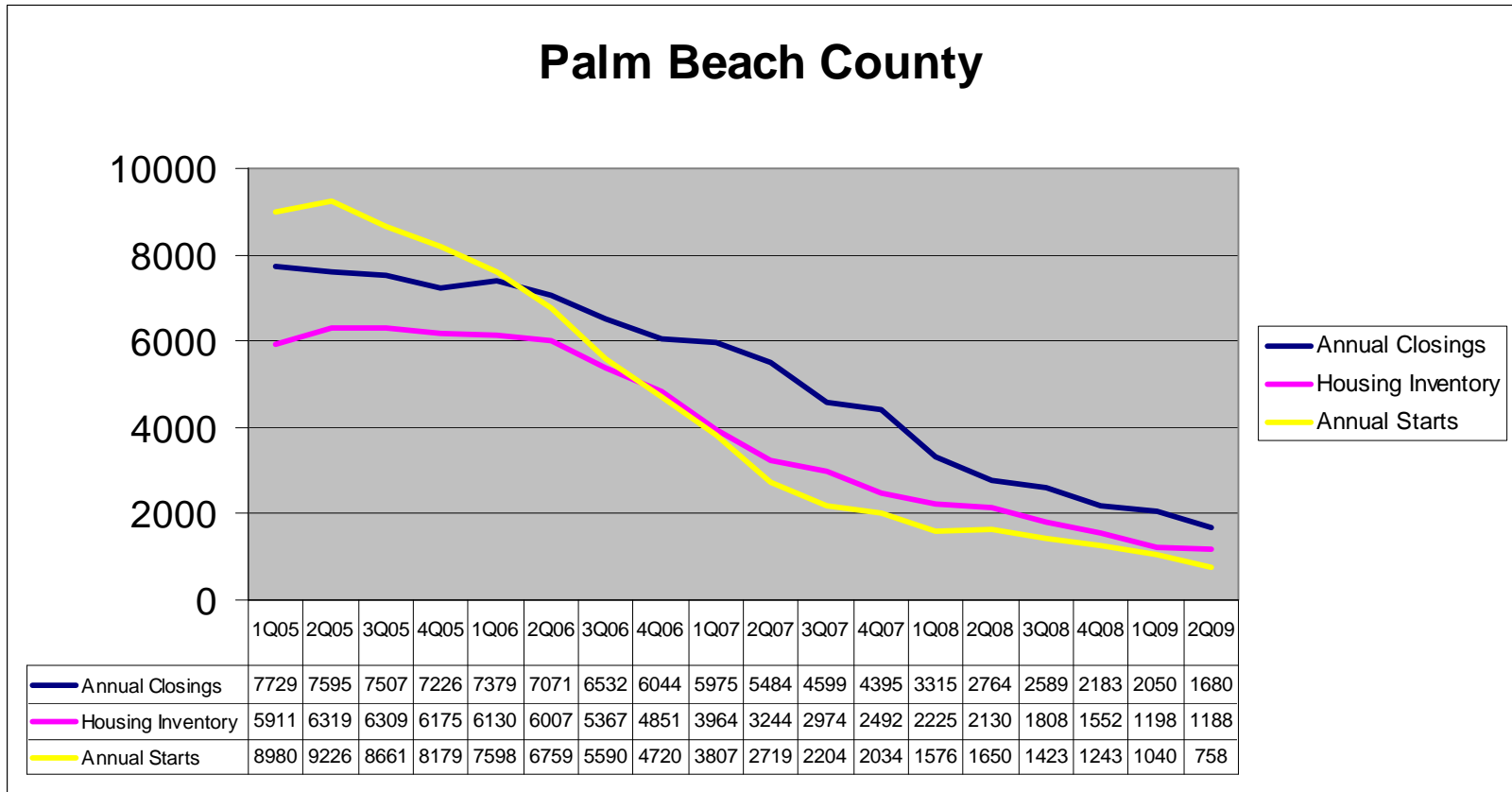
New Construction Trends

Martin County



	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Annual Closings	999	969	807	704	754	818	841	869	792	662	629	590	535	511	444	376	322	274
Housing Inventory	593	715	901	978	897	891	945	879	808	720	659	554	471	445	377	320	268	225
Annual Starts	998	990	1001	1040	1058	994	885	770	703	491	343	265	198	236	162	142	125	60

New Construction Trends



Inventory has declined every quarter since Q2 2006



Foreclosures

Florida Past Due Home Loans & Foreclosures

1-4 Family Residential – Q1 2009 – Mortgage Bankers Association

	% Past Due	30 Days	60 Days	90 Days	90 day + Foreclosure % of Loans
Prime Fixed Rate	6.45%	2.48%	1.26%	2.70%	7.04%
Sub Prime Fixed Rate	22.54%	8.17%	4.45%	9.92%	24.39%
Prime Adjustable Rate	13.52%	3.47%	2.96%	7.69%	24.29%
Sub Prime Adjustable	21.12%	5.51%	4.00%	11.61%	52.63%
FHA (Fixed)	13.59%	5.51%	2.44%	5.64%	11.42%

Source: Mortgage Bankers Association

New Foreclosure Filings & Ratio to Housing Units – June 2009

Seacoast County	New Filings June 2009	Change From May 2009	Ratio to Housing Units	Rank in State
Orange	2,148	-27.41%	132	8
Seminole	614	+12.45%	202	25
Osceola	674	-39.46%	92	2
Lake	645	+16.45%	128	5
Brevard	623	-23.75%	234	29
Indian River	191	+51.59%	248	30
St. Lucie	357	-28.04%	145	11
Martin	398	+182.27%	160	13
Okeechobee	59	+210.53%	163	18
Hendry	60	-3.23%	130	27
DeSoto	28	0	483	48
Glades	2	0	2,022	23
Highlands	129	+8.40%	275	33
Hardee	14	-22.22%	499	26
Palm Beach	2,866	-17.62%	200	24
Broward	3,264	+145.31%	126	4
Florida				

SOURCE: Realty Trac

Foreclosure Facts

- Florida is second in the nation for foreclosures.
- Nearly 22 million American homeowners owe more on their property than it is worth. An estimated 2-2.5 million are in Florida.
- Huge incentive to walk away
- Foreclosures are slowing recovery.
- **Foreclosures will have a huge impact on the broader economy well into 2011.**
- The lingering effect of foreclosures will limit price increases for several years after the housing market has bottomed and the economy turns positive.

U.S. Foreclosure Rankings In June

California 391,611

Florida 268,064

Arizona 89,799

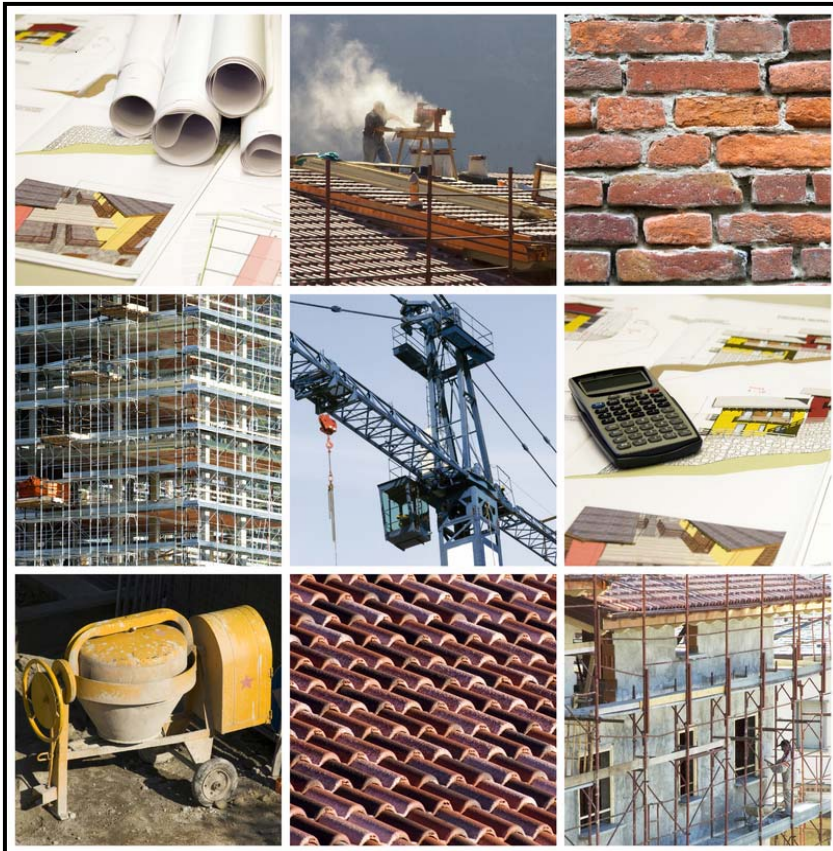
Nevada 68,708

Michigan 60,786

The New Face of Foreclosure

- Prime sector is now falling into foreclosure at a faster rate. According to S&P, dollar volume of prime defaults rose 13.8% in the second quarter. Prime borrowers are giving up in larger numbers.
- Strategic foreclosure. Borrowers intentionally default even if they can afford to pay.
- According to a study (researchers from Northwestern, University, University of Chicago and European University Institute), **26% of defaults are strategic**. Moral barriers are falling.
- Working paper by NBER researchers shows that value decline is about 28% after foreclosure. Spillover effect. Each foreclosure that takes place tends to lower the value of a houses within 0.05 miles by about one-percent.

Looking Forward at Commercial Real Estate



The commercial real estate sector stayed afloat long after the residential sector began to sink and even as the broader economy began to weaken. Nevertheless, the commercial sector began to falter in early 2008. Today, most commercial real estate product types are under stress, values have declined significantly and no positive change is likely in 2009. Commercial real estate fundamentals are weakening dramatically due largely to declining employment which is now taking a large toll on spending and office jobs thus adversely impacting all major CRE sectors (office, retail, industrial and multifamily).

What Happened?

- Commercial development increased dramatically in response to anticipated growing residential development.
- Fuelled by low vacancies and rising rents, values increased disproportionately and capitalization rates began to slip into low single digits.
- *Cap rate compression* began in about 2002 and continued for the next five or six years. Investors were virtually shut out of the market if they did not bet on future growth and buy on the basis of these unsustainably low rates.

What Happened?

- When spending began to decline coincident with a slowing economy, retail real estate was negatively affected by growing vacancy, reduced rents and prolonged absorption.
- When office jobs began to decline due to diminished need for real estate support services, office real estate felt the pressure especially in suburban locations.
- When there was less need for warehousing to serve the construction sector and to store appliances and furniture for new homes, that sector began to deteriorate. As all these factors, plus unemployment converged to reduce manufacturing, the industrial real estate sector began to soften.

Where are we today?

- Commercial real estate has surpassed residential in terms of its rapid and unprecedented value and price declines.
- Prices and values have deteriorated more quickly than they did during the crisis of the early 1990's. According to RERC values declined 20-25% in just *two quarters* as compared to 30-35% in five years in the late 1980's and early 1990's.
- According to Deutsche Bank, the delinquency rate on \$700 billion in securitized loans also doubled in two quarters.

Where are we today?

- CRE prices will likely slide 15% to 20% in 2009 due to:
- Rising vacancies, lower rents, rising capitalization rates and inability to refinance maturing debt.
- An additional 10% to 15% slide is possible in 2010 *without dramatic improvement in the CMBS market, employment and the broader economy – none of which appear likely at this time.*
- Today there are 2.5 times the dollars needing to be refinanced than there are dollars to refinance them. Unthawing the CMBS market is critical. Banks do not have balance sheet capacity to absorb what needs to be refinanced.
- Current CRE demand is negligible. The need today is to refinance debt created by five year old demand – much of which was not real demand.

Where are we today?

- Capitalization rates up 200 bps (now 8.0-10.0) from compression era (2002-2007) rates of 4.5% to 6.5%
- Lease renewal probability: 64% (RERC)
- Time to re-lease: 7.4 months.
- Lease vs Sub lease difference: -13.85% (20%+ in some markets)
- Investment Conditions (Hotel worst followed closely by retail. Apartment best followed by warehousing. (RERC survey)

The CRE Debt Bubble

- According to New York Based Real Capital Analytics (RCA), approximately \$2.2 TRILLION in CRE projects acquired or refinanced between 2004 and 2008 have lost value.
- Equity of \$1.3 TRILLION has been wiped out or remains at risk.
- Prices of office, retail and industrial properties have fallen 34.8% since their October 2007 peak.
- The dollar value of distressed properties rose by \$67 Billion to \$115 Billion in the first half of 2009. That's an increase of 122%.
- According to the Federal Reserve, U.S. banks hold about \$1.8 Trillion in CRE loans.

The CRE Debt Bubble

- CRE delinquencies are now near 7% exceeding the early 1990's when they hit 6%.
- The bubble continues to inflate as only about 10% of troubled assets have been cleared largely in one-off transactions. Many investors appear to be waiting for the bubble to burst to acquire assets at pennys on the dollar.
- The government's Troubled Asset Relief Program (TARP) morphed into something far different than originally intended and has not been successful in clearing troubled assets.
- The government's Public Private Investment Partnership (PPIP) has been largely unsuccessful due to its perceived onerous terms and investor's unwillingness to trust the federal government not to change the terms.

Recovery Comes Into View



Signs of Renewed Economic Life

- Economic freefall that began last fall with the near collapse of the financial system has slowed.
- Consumers are seeing lower energy prices, bigger tax refunds, tax cuts, refinancing wave and higher social security payments.
- Consumer confidence, though still low, has risen from its historic low.
- Most damage to household wealth may already have occurred. There are clear signs that housing and equity markets are at or near bottom.
- Housing inventory is starting to clear.
- Affordability has returned to the housing sector.
- Architectural billing index is up.



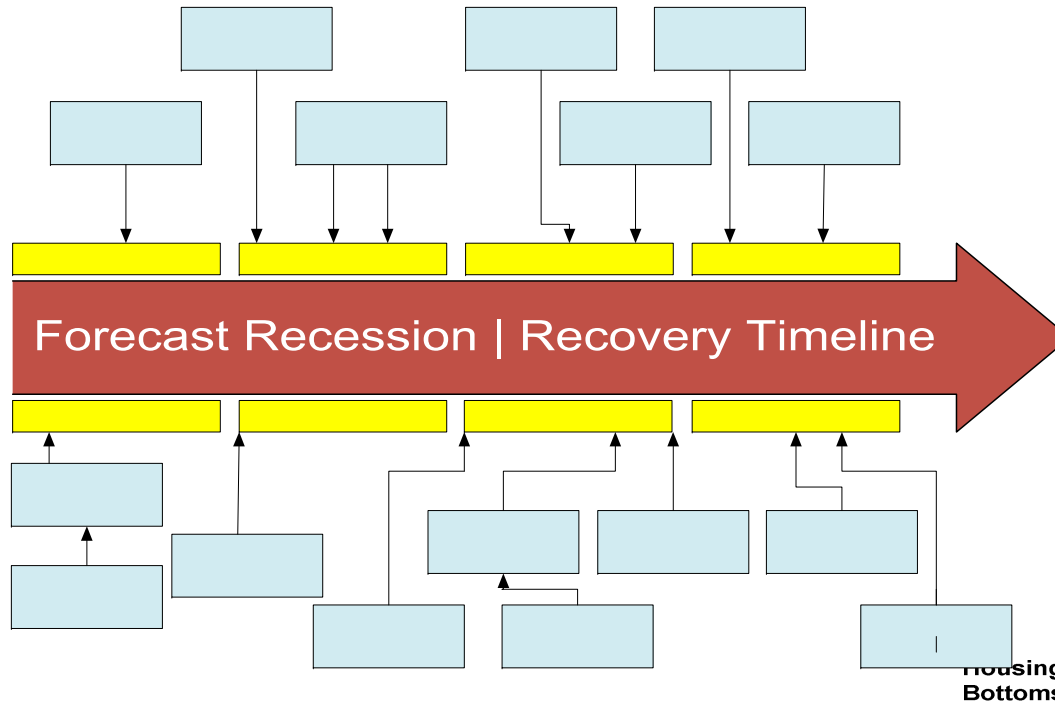
Green sprouts of new life will emerge but not all will take root and survive.

Signs of Renewed Economic Life

- Rate of median home price decline has slowed and sales volumes are increasing nationally, in Florida and in most Seacoast served markets.
- While housing and the broader economy will likely achieve modest recovery, commercial real estate will continue to weaken thus exacerbating full recovery and return to robust growth for several years.

Forecast Recovery Time Line

Forecast Recession | Recovery Timeline



Housing Forecast

Barring Additional Unforeseen Economic Shock

- Housing starts have bottomed.
- The housing free fall is over. Housing prices are at or near bottom. Any additional decline will likely be modest in most Seacoast markets.
- Foreclosures and distress transactions will keep a lid on value increases for the next few years.
- After the downturn of the late 1980's and early 1990's it took roughly seven years for the market to return to robust growth. It took condos roughly 13 years.
- Significant new development is unlikely before mid 2012. Even then it will be scattered. New development will be curtailed by the absence of economic feasibility driven by lengthy absorption periods, etc.

Gross Domestic Product

Barring Additional Unforeseen Economic Shock

- Q2 contraction was 1.0% much improved over the Q1 decline of 6.4%.
- GDP will likely turn positive later this year or early 2010 which may trigger an official declaration that the recession is over.
- *Growth going forward will still be sluggish. There is nothing to suggest either quick or robust growth.*

Employment Forecast

Barring Additional Unforeseen Economic Shock

- Employment will lag recovery.
- Employment will decline and unemployment will rise into 2010 although at a less severe rate than experienced in the second half of 2008 and first half of 2009.
- Unemployment will remain elevated (7-8%) for several years. It will likely be 2014 or 2015 before Florida regains its pre-crash peak employment. Cycle low unemployment rate during the run up (2005) was 3.3%.
- Why? Many job losses today are permanent rather than cyclical.

Credit Forecast

Barring Additional Unforeseen Economic Shock

- Credit availability will improve over the next 24 months however it will not reach its pre-crash rate.
- Banks continue to struggle with capital and liquidity issues as well as unhealthy loan concentrations.
- Bank failures between 2008 and 2012 may rise to 700 which is roughly equivalent on a percentage basis to the five year period between 1989 and 1993 when there were twice as many banks as there are today.
- Bank loan losses have been extraordinary and are unlikely to normalize before late 2010. Loan losses going forward will be driven by commercial real estate.

Commercial Real Estate Forecast

Barring Additional Unforeseen Economic Shock

- Commercial real estate began to weaken in 2008 and has not yet reached its depth in terms of severity.
- *Will be the weak link in recovery going forward.*
- Like residential before it, values will return to pre-run up levels with an overall decline in the 35% range.

Foreclosure Forecast

Barring Additional Unforeseen Economic Shock

- Best Case: Foreclosures will slow in 2010 as modification programs gain momentum.
- **Most Likely Case:** Foreclosures will continue through at least 2011.
- Worst Case: A new Deutsche Bank study suggests that a full 50% of homeowners could owe more on their homes than the property is worth. Study assumes that prices will continue to fall. That will lead to rising foreclosures for several additional years.

Questions or Feedback?

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