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FEDERAL RESERVE BANK OF KANSAS CITY

Winter 2009

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PHOTO BY JOSHUA LAWTON

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Global Financial Crisis and the Regulatory Environment: Where Do We Go From Here?

The current financial crisis is posing new challenges for central bankers and policymakers, taking them well beyond the traditional framework they have used to address previous crises. In part, these new steps reflect dramatic changes in the financial system—most notably a substantial growth in that part of the market not covered by traditional public safety nets, along with a rising complexity in financial instruments, counterparty risks, and institutional relationships on both a domestic and global basis.

These developments are complicating efforts to respond to the current crisis, while also revealing serious shortcomings in our crisis management framework. For example, many of the steps taken have raised important issues with regard to moral hazard and the subversion of market discipline, equitable treatment of different institutions and segments of the market, and public interference in credit allocation and other market processes.

These issues strongly suggest a need to look carefully at what we have done and consider what principles should guide any further steps we take in addressing the crisis. Moreover, it is appropriate to begin thinking about how we might construct a clearer set of rules and policies to help create more resilient financial markets and a better crisis management framework for responding to future events. Such thought should also include exit strategies for how we can terminate the numerous temporary assistance programs adopted in this crisis and restore the private market incentives we have sacrificed.

I will focus on three policy issues: (1) How will we determine which institutions are to be covered by the public safety net and, accordingly, subject to close supervision? (2) What is the appropriate scope for central bank lending? (3) How should we resolve solvency problems at nonbank financial institutions? Before proceeding, though, I would like to briefly share my perspectives on some of the general lessons we have learned from the crisis.

What have I learned?

One of the most obvious observations from the current turmoil is that a crisis can stem from parts of the financial market not covered by traditional public safety nets. In past crises, we have typically been able to direct our efforts toward banks and other depository institutions where we have safety nets and a supervisory and regulatory framework to address institutional problems and restore market confidence. However, many of the institutions and markets now under stress are not subject to prudential oversight. They are not protected by well-defined safety nets and, when assistance is provided, do not have a framework in place to help address moral hazard and other policy issues.

Also, when confidence is fragile and the risk of contagion is great, central banks and other public authorities increasingly are compelled to provide extensive liquidity and other assistance to the nonbank portion of financial markets. In this regard, it is clear in the United States that whenever threats to financial stability occur, the financial markets, the public and the political authorities all look to the Federal Reserve to respond regardless of where the threats originated.

We should further acknowledge that an enormous burden has been placed on monetary policy to respond to the current crisis, although monetary policy is not designed to address many of the underlying factors, particularly when the problems extend beyond liquidity and raise issues

of solvency and informational shortcomings. Going forward, it will be essential that our financial system has a wider range of policy and market-based options to resolve crises, with less reliance being placed on monetary policy.

How will we determine which institutions should be covered by the safety net?

Because many of the problems in this crisis are linked to institutions and markets not covered by traditional public safety nets, we clearly need to rethink what our approach should be in providing assistance to these segments and, accordingly, in extending oversight and regulation to them.

As we begin to think about these issues, I believe it is important to have a clear understanding of what we are trying to accomplish. In my view, a public policy objective of maintaining financial stability should involve two key features: preventing credit disruptions emanating from financial markets and financial institutions from adversely affecting the broader economy, and maintaining the integrity and functioning of the payments system.

From a historical perspective, safety nets and supervision have been tailored to the specific charters under which financial institutions operate and offer products. As a result of competition and financial innovation, many of the distinctions between financial institutions and products are eroding. The current crisis, along with this growing convergence among institutions, raises many questions about what criteria should be used and how far we should go in deciding which institutions should operate under safety nets and prudential supervision.

In general, I favor limiting the scope of our federal safety net. In a number of ways, we struggle in dealing with banks that are regarded as too big to fail and in finding the appropriate balance between market and supervisory discipline. Such problems would be greatly magnified if we were to permanently extend the safety net to encompass a growing range of institutions and markets. I am especially concerned that we could put ourselves in the position of mixing banking and commercial activities if we were to extend financial assistance to firms conducting a wide range of activities. Such assistance could put public authorities further into the process of allocating credit and selecting the winners and the losers in the marketplace.

Having said that, we still need to look carefully at the safety net issue and think about what we should do, given the likelihood we will have to deal with problems in the broader financial markets again. Can we design a more limited safety net for this part of the market, supported by an equally limited system of oversight and regulation? Can we accomplish this without stifling the type of innovation that makes our markets more efficient and more responsive to customer needs?

I am not sure any of us have a good answer to these questions. I have several suggestions focused on trying to lessen the need for safety nets.

“ In general, I favor limiting the scope of our federal safety net. ”

Because overleveraging has been a major problem during the current market meltdown, I would suggest extending some form of leverage standards—a minimum capital-to-assets ratio—to those portions of the market that have suffered from inadequate capital. This type of capital standard would also help reinforce the pressure that financial investors and creditors are now putting on firms to raise capital and clean up balance sheets.

In this regard, I have always supported simple leverage standards for financial institutions. If we extend capital standards to a broader range of firms, a leverage ratio seems more advisable to me than risk-based capital standards, which are likely to be far more complex, procyclical, and, in many ways, easier to evade. In fact, I am most concerned that any institution that tends to underestimate its risk exposure—as many recently have—will be just as likely to underestimate its capital needs if allowed to operate a risk-based capital standard, such as Basel

II. Risk-based capital standards may also encourage institutions to lower their capital, instead of building it up, in the prosperous times that typically precede a crisis.

I am also intrigued by the ideas presented at our Jackson Hole Symposium for making capital vary in a more beneficial way over the business cycle and during a crisis. One idea is the use of capital insurance to facilitate a financial institution's recapitalization during a systemic financial crisis. Another related idea is mandatory debt-equity conversions to supplement capital in a financial crisis and to provide more discipline on the part of bondholders. As part of any such recapitalization, I support the mandatory cessation of dividend payments with the loss of earnings.

Supervisory oversight of institutions that affect an economy's financial stability is important. And, the most difficult aspect of this is that we balance supervisory authority and capital requirements against the need to maintain financial innovation and not drive activities into less-regulated markets. This is one reason why I would prefer to limit the safety net to protecting the intermediation and payments mechanisms, while giving market forces as much latitude as possible to guide financial innovation.

There may also be other ways that we can strengthen institutions and markets while lessening the need for safety nets. I have long supported increased public disclosure. With the information problems present in today's markets, we need to work with market participants in a concerted effort to improve disclosures and remove as much of the complexity and opaqueness as we can.

Overlapping these questions are two further issues: the appropriate scope of central bank lending and the resolution of solvency problems at nonbank financial institutions.

What is the appropriate scope for central bank lending?

Traditional central bank lending has been through the discount window with eligibility generally restricted to depository institutions. For the most part, central bank lending also has been short-term and fully collateralized with sound assets. During the current crisis, though, the Federal Reserve and a number of other central banks have chosen to expand the use of their lending facilities.

For the Federal Reserve, these efforts have included a number of different measures: a Term Auction Facility designed to increase liquidity among depository institutions; an expanded securities lending program with broader collateral requirements to make illiquid securities more liquid; a primary dealer credit facility to increase liquidity at investment banks; lending to fund the resolution/workout of several large nonbank financial organizations; and most recently, funding to support money market mutual funds and the commercial paper market.

This broadening of central bank lending reflects, in part, the expanding role that nonbank financial institutions and more complex financial instruments play in the system. A key question now for central banks is: Should central bank lending return to its traditional role once the current crisis abates, or is this broader role the new reality?

Broadening the scope of central bank lending has raised a number of issues, some old and some new. A long-standing concern is that central bank lending should not be used to prop up insolvent institutions, allowing them to take further risks that could end up costing the taxpayer.

But the broadened scope of central bank lending raises new issues as well. For example, why should institutions and financial markets maintain much liquidity on their own if they know central banks are likely to provide it when needed? Related to this is the idea that central banks may be subsidizing access to liquidity for a growing list of borrowers. In addition, an expanded role for the discount window may bring central banks more directly into allocating credit as collateral requirements are selectively relaxed and lending is used to support specific segments of the market.

While it may be too early to decide how central bank lending should be used going forward, we should start developing the basic principles. Here are some ideas that I suggest for consideration.

I have already indicated my preference for putting some bounds on the federal safety net. But if the discount window—as part of that safety net—is to be available to a broader range of institutions, then these institutions should be subject to some form of oversight and regulation to reduce moral hazard concerns. This oversight would help bring lending to nonbank financial institutions into closer conformity with that of depository institutions.

We should think of how central bank lending could be structured to keep it from being a subsidized source of liquidity. Because this lending is essentially a line of credit, one idea is to charge a fee for access, then require institutions seeking emergency access without a funded line of credit to pay a higher penalty rate.

A final consideration is how far central bank lending should be extended. The focus should be on protecting the intermediation process and the payments mechanism. Because of the credit allocation issues and other concerns, I would argue for at least drawing a sharp line between banking and commerce, with our discount window only used to fund institutions and markets that play strictly a financial role.

How should we resolve solvency problems at nonbank financial institutions?

One other key issue arising out of the current crisis is our approach in dealing with nonbank institutions that face solvency crises. Major examples of this now include Bear Stearns, Lehman Brothers, AIG, and Fannie Mae and Freddie Mac. In each case, a unique approach has been followed. To some extent, these approaches reflect differences in the structure and exposures of these institutions. In some cases there were rushed decisions on whether they are too big to fail. However, it is apparent that we would benefit from a clear set of rules for handling such firms, much like we have established to deal with failing depository institutions. As it is now, we only have two, more problematic choices: Putting together ad hoc rescue packages or relying on the more drawn-out corporate bankruptcy process, which may raise added concerns and liquidity problems during a financial crisis.

We have some history in the United States on how to deal with large failing banks. This experience is far from perfect, especially with regard to banks viewed as too big to fail, but we have been able to construct a resolution framework that safeguards our payments system and helps to maintain public confidence.

For example, our bank resolution framework focuses on timely action to protect depositors and other claimants. Insured depositors at failing banks typically regain full and immediate access to their funds, while uninsured depositors often benefit from quick, partial payouts based on expected recoveries. Also, a continuation of many banking activities and relationships is likely to occur given such resolution options as deposit transfers and asset sales to other banks, purchase and assumption transactions, bridge banks, conservatorships, and open bank assistance. Other important features of the bank resolution framework include depositor preference statutes and a clear priority for handling other claimants, as well as an orderly receivership process with limited allowance for judicial intervention.

We have a system of prompt corrective action by supervisors and, in the case of failure, bank resolutions that impose the least possible cost on the FDIC. These provisions help promote a resolution of banking problems before they can become magnified and more costly to the industry and, ultimately, to taxpayers. Requirements for least-cost resolutions and priority of claimants also help to put stockholders, subordinated debtholders and uninsured depositors at risk, thereby lessening some of the moral hazard concerns associated with the federal safety net. Exceptions to least-cost resolution can be made when the failure of an institution could pose a systemic risk, but even in such cases, regulators can still make stockholders and managers bear the risk of their actions.

I offer the thought that similar principles should be followed in setting up a resolution process for other types of financial institutions. The uncertainty that surrounded recent workouts of nonbank institutions has not only lowered market confidence, but also provided inconsistent treatment of stockholders and creditors. In addition, the bankruptcy of Lehman Brothers has raised doubts about how different claims will be handled and how long the court and receivership process will take.

In establishing a resolution process for nonbank financial institutions, there are a number of important principles to follow and several issues to consider. First, whatever the range of institutions granted access to the public safety net, we must design a process that limits moral hazard concerns and encourages market discipline. In particular, we must acknowledge that the market will make better decisions on capital and leveraging when investors and management are subject to the possibility of loss. As a result, nonbank resolutions or takeovers should leave stockholders and subordinated debtholders fully exposed to the losses in their firms. In the same way, such resolutions should provide for new management and directors either through a merger with a sound institution or the insertion of a new management team.

Other resolution steps should be structured to help ensure a continued flow of financial activities, especially with regard to custodial accounts and any short-term claims that might harm counterparties if not resolved in a timely manner. A continuity of operations could be facilitated through mergers, conservatorships or something similar to the FDIC's bridge-bank powers, especially for large institutions that might pose a systemic risk if their operations were disrupted.

I would also suggest using something similar to open-bank assistance for nonbank financial institutions that appear to be viable. However, this is only provided that the assistance is structured in a manner that does not subsidize stockholders or creditors or enable institutions to take on more risk. As in banking, the authority to take action in a timely manner would help to reduce losses and best protect customers and creditors and their access to accounts and funds.

A final set of issues is how to fund resolutions at nonbank financial institutions and who would be in charge of the process. In order to protect taxpayers, I believe that industry resources, wherever possible, should be used to provide the major source of funds—much like in banking with the deposit insurance fund. We should be giving thought to how such a fund could be established, particularly for less-regulated portions of the financial markets.

Concluding comments

It is clearly time to take a comprehensive look at our financial system and its regulation. We have experienced financial crises in many different parts of the world over the past few decades, and the current financial crisis may be the most extensive one we have experienced since the 1930s.

Over the last year, central banks and other public authorities have taken a nearly unprecedented series of steps—steps that virtually all of us would admit are well outside of our comfort zones. Also of concern to me is that recent public actions may result in unintended effects, most notably in terms of creating unwelcome incentives, unjustly favoring selected participants and segments of the financial markets, and putting taxpayers at significant risk.

To address these issues and concerns, we need to have a clearly understood framework to make our financial system more resilient in the face of unexpected events and to resolve problems in our financial markets when they invariably arise. In keeping with these objectives, I have tried to present a few ideas and basic principles for how we might structure public safety nets, discount window lending and resolutions of large nonbank financial institutions.

There are obviously many issues to be resolved as we go forward, and I will certainly be interested in finding out what ideas all of you have for longer-term reform.

President Hoenig delivered these remarks on Nov. 17 at the Institute of International Bankers' conference in New York.

Thomas M. Hoenig

THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY

KIMBERLY BLOOMER visits Eldorado Canyon and other Colorado state parks weekly. Their upkeep is funded in part by state tax revenues, which are affected by economic conditions.

PHOTO BY JOSHUA LAWTON

REVENUE STREAM

How state taxes fund public services, amenities

Kimberly Bloomer is a home health aide who spends hardly any free time in her own home.

"I'm constantly outdoors," she says, listing off her favorite state parks in Colorado that she visits to rock climb, mountain bike and hike year-round.

Bloomer, 38, realizes some of the state taxes she pays in part fund the parks' upkeep, but says she wouldn't be willing to pay higher taxes in order to avoid cuts, such as reduced hours or maintenance, although she would want any cutbacks to be minimal.

"I love state parks," Bloomer says. "It's pretty much why I live in Colorado."

While Colorado's state parks haven't experienced a reduction in hours or services since 2004 (which caused a loud public outcry), the state's government and others are challenged to maintain state-funded services without raising taxes, especially during tough economic times like these.

Many factors influence state tax revenues, but a major component is the makeup of its tax portfolio. Just like individual investors, each state has a tax portfolio with a varying assortment of revenue sources, such as income tax and sales tax. This pays for state services, whether it's parks, schools, state troopers or correctional facilities.

"A state's tax portfolio plays a critical role in determining the growth and stability of tax revenues," says Alison Felix, an economist with the Federal Reserve Bank of Kansas City. Felix recently researched tax revenue sources in the Tenth Federal Reserve District, measuring growth and stability during the past 40 years. The District's states are Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and New Mexico.

"This is important for understanding the overall performance of state tax revenues," Felix says. "Taking a look at the growth and stability of each tax instrument makes it possible to assess potential risks and rewards of a state's overall tax portfolio."

Unlike the federal government, states must have a balanced budget. State tax collections are closely related to the economic health of a state as well as the nation. For example, volatile corporate tax revenues and reduced personal income tax revenues (as capital gains slow from a sagging stock market) have negative effects on state tax revenues.

"When times boom, revenues abound," Felix says. "When the economy takes a downturn, revenues tend to follow."

During this nationwide economic downturn, more than half of all state governments are projecting budget shortfalls in 2009 totaling billions. Although Felix says tax revenues for District states likely will fare better in the near term than revenues for the nation as a whole, the tough times are evident. For example, Colorado recently announced a hiring freeze on new state employees and a halt on new construction, including a full-day kindergarten project. Although Wyoming has a surplus, the state tapped its rainy day fund to balance the '09 budget, and Nebraska predicts future reductions to its K-12th grade education, according to the National Conference of State Legislatures.

"Residents don't like either option," Felix says, "but less money coming in means state services are going to get cut or taxes will be raised. Therein lies the challenge for state governments."

> "Growth and stability are important characteristics of tax instruments."

What's in states' portfolios?

To make up their portfolio, states choose from a variety of tax sources, each of which responds to varying degrees to changes in the overall health of the economy. Sales tax on food, for example, is stable because people buy food regardless.

"Growth and stability are important characteristics of tax instruments," Felix says. "Because these vary for each tax source, the right balance can be a challenge."

During the past 40 years, District states have become more reliant on personal income taxes and less so on selective sales taxes, but there haven't been many major changes to states' tax structures. Felix's research shows state tax revenues have grown faster than personal incomes during the past 40 years. In the District, most states' tax revenues are more volatile than personal income. As the economy fluctuates, the volatility of tax revenues means how much revenues respond to these changes.

Felix examined the growth and volatility in the past 40 years of the five most important tax sources in states' portfolios in the District:

General sales taxes: Revenues grew at a similar pace as personal income. These revenues were generally less volatile than others, but a drop in consumer spending leads to a drop in sales tax revenues. The structure of general sales taxes varies widely. Many states exempt food (including Nebraska, Wyoming, Colorado and New Mexico) and prescription drugs (including all District states) from sales taxes. Another difference is the number of services (utilities, professional services and others) taxed. For example, in 2007, Colorado taxed 14 services and New Mexico taxed 158. Taxing a large number of services boosts revenue growth and can reduce volatility through diversification, Felix says.

Selective sales taxes: These include taxes on tobacco, alcohol and gasoline; their revenues have grown slower than personal income. These taxes were the slowest growing and least volatile in the District—as their incomes grow, people don't greatly change their tobacco use, for example. Consumption of these goods doesn't decrease much during economic slowdowns either.

Personal income taxes: These were the fastest growing revenue sources nationwide and in the District. Although they grow faster than personal income (more than double in the last 40 years), Felix says they were more volatile because, in most states, capital gains are taxed as ordinary income—stock market returns are more volatile than personal income.

Corporate income taxes: Revenues grew slower than personal income and were the most volatile in both the nation and the District.

Where does state tax revenue come from? Composition of state tax portfolios in 2007

How are state services like roads, correctional facilities and public education funded? Your taxes.

In most states, general sales taxes and personal income taxes make up the largest share of total tax revenues. Selective sales taxes include motor fuel, alcohol, tobacco and others, and represent 15 percent of the average general fund. Corporate tax revenues make up 7 percent, and severance taxes (imposed on the extraction of a state's natural resources that will be used in other states) and other taxes (such as property taxes) make up about 11 percent.

Overall, the Tenth District states rely more on personal income and severance taxes, and less on sales and corporate taxes. State tax portfolios in the District are somewhat unique to the national average.

Some noteworthy components of portfolios in the District from the past 40 years include:


PHOTO BY GETTY IMAGES

The slow growth can be attributed to state governments' increased use of business tax incentives through the years. In the late '90s, only Nebraska and New Mexico in the District didn't offer corporate tax exemptions, and had the fastest growth of corporate revenues of District states.

Severance taxes: Extracted natural resources like oil, natural gas and coal bring in almost a billion dollars a year each to New Mexico, Oklahoma and Wyoming. Severance tax revenue in the District has grown faster than personal income, due to price increases and increasing tax rates. These revenues are highly volatile, primarily because prices of natural resources are often unstable. The District's overall strong reliance on severance taxes provided a revenue boost while the price of natural resources was at an all-time high last summer, Felix says.

HAVING A BALANCED TAX REVENUE PORTFOLIO that maintains services without much change in taxes is a challenge for states. Residents don't want services, like education or highways, cut.

Where does the money go?

Whether visitors want to go ice fishing and snow shoeing at Steamboat Lake, or rock climbing and horseback riding at Eldorado Canyon, $7 per vehicle gets them a day pass (or $60 per year) at any of Colorado's 40-some state parks.

And although the parks see about 11 million visitors a year, entrance fees only cover about a third of the expenses, which includes upkeep, staffing and visitors' services, says Deb Frazier, Colorado State Parks communications manager. The parks rely primarily on a combination of state sources to fund its $62 million annual budget.

"If there's a slowdown in the economy, especially if gas prices are high, it cuts both ways," Frazier says, explaining less tax revenue comes in and fewer out-of-town visitors go to the parks, though there still seems to be a high number of local visitors opting for a "staycation."

Frazier doesn't anticipate budget-related cuts in the near future, thanks in large part to the nearly 7,000 volunteers—like Kimberly Bloomer, the home health aide, who volunteers as a trail builder.

"These are very special places to people," Frazier says. "The loss of that is something that cuts deeply."

Since moving to Westminster, Colo., from Pittsburgh, Penn., about nine years ago, Ed Twele discovered his new "passion." Twele, 50, frequents the state parks weekly to fly-fish. He and his wife, Cathy, also go hiking and cross-country skiing, and enjoy taking their out-of-town visitors to the parks as well.

"I want to be able to go there whenever my schedule permits," says Twele, who is a

partner in a financial advising firm. "I would rather pay higher taxes than have reduced services or hours."

For many states, unpopular budget cuts are certain. There is an "incredible amount of linkage" between a state's economic health and its revenues generated from personal income tax and general sales tax, says Arturo Perez, a fiscal analyst with the National Conference of State Legislatures, a bipartisan organization that provides research and other assistance on state issues to legislators. For example, a slow economy spikes unemployment and reduces personal income tax revenues, or affects spending and reduces general sales tax revenues.

PHOTO BY GETTY IMAGES

In response to reduced revenues, states typically cut spending first to balance their budgets, followed by, if necessary, tapping reserves, and finally raising taxes. Sometimes federal fiscal relief can be an option.

"Each state has its own priorities," when it comes to balancing the budget, Perez says, but when it's time to cut, "higher education is a favorite. It's the largest discretionary area of state spending."

States' current budget shortfalls somewhat mirror those seen after the dot-com bust and post-9/11, Perez says. These downturns were short and revenue performance was back up until 2007. As for how states will fare this time, he says it all depends on the severity of the nationwide downturn.

Importance of portfolios

A national slowdown affects each state differently because of the makeup and performance of its tax portfolios.

"There are states which are in a huge heap of trouble," says David Blatt, director of policy at the Oklahoma Policy Institute.

Oklahoma, and other states in the District, is not as severely affected because severance taxes helped spare the state. While Oklahoma is not in a budget crisis, there are some strains, namely in the health-care and education sectors, Blatt says.

Roy Bishop, a former teacher of 15 years and now the president of the Oklahoma Education Association, a 40,000-member advocacy organization, says, "We have to get past the mantra that taxes are the worst thing ever . . . . This is what pays for your services. Tax dollars are an investment in our society."

Economic fluctuations can reinforce the importance of states' portfolios, Felix says. While she is not suggesting one type of tax or portfolio is better than another, Felix says portfolios should be developed to fit a state's economic makeup because each potentially affects the state's economic growth, and in turn residents' services.

"To maintain revenues that can keep pace with increasing constituents' demands and survive economic downturns," Felix says, "policymakers should be aware of the growth and volatility of each tax source."

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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"THE GROWTH AND VOLATILITY OF STATE TAX REVENUE SOURCES IN THE TENTH DISTRICT"
By R. Alison Felix
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

PHOTO BY GARY BARBER

Measuring up

Commercial real estate comparable to early ’90s

During this global economic downturn, Brad von Gillern has been getting some pretty heavy questions from his crews at Lueder Construction Company in Omaha.

"Am I going to have a job?"

Though some of the 65 or so employees are delaying retirement and the company's competition with other general contractors is heightened, von Gillern answers that question with certainty: "Yes."

Lueder Construction, a full-service contractor that does concrete work, carpentry, masonry, steel erection and more in the commercial market, isn't laying off employees.

"We've had more work under contract now than we ever had," says von Gillern.

Such activity in the commercial sector may seem surprising in light of the residential market's state, but he says the majority of the projects his firm does, which include schools, medical facilities and churches, is doing better than retail—a sector of commercial real estate seeing high vacancy rates from overbuilding a few years ago when financing terms were looser and overall economic conditions were stronger.

"Everybody's worried," von Gillern says, but he thinks the commercial real estate sector will ultimately fare better than the residential real estate market, which was the first domino to fall in the current global financial crisis.

During the summer of 2007 when the market for securities backed by subprime mortgages collapsed, uncertainty and fear resulted in illiquidity for any asset linked to subprime mortgages. Over time, the liquidity problems spread to other financial markets and severely affected some banks and securities firms. In real estate, home values have dwindled and foreclosure rates have soared. Commercial properties are feeling the effects of the subprime housing lending meltdown, too.

"There is some concern about the U.S. commercial real estate market and the impact it may have on financial markets and institutions," says Alan Garner, professor of economics at Avila University and former assistant vice

PHOTO BY GETTY IMAGES

IN THE EARLY '90s, looser financing and stronger economic conditions led to overbuilding and high vacancy rates. Current commercial real estate doesn't seem to be overbuilt to the same degree.

president and economist at the Federal Reserve Bank of Kansas City.

This sector has slowed recently, and Garner says many effects are evident, including:

- An increase in the interest rate on commercial mortgage-backed securities compared to the interest rate on the safe haven of U.S. Treasury securities;
- Declining prices for commercial properties;
- Reduced lending from financial institutions;
- A slowdown in commercial construction activity and reduction in related jobs.

"Historically, commercial real estate has been subject to booms and busts," Garner says. "Looking back may provide clues to how this current situation will play out."

Not long ago

In his research, Garner compared the current economic situation to the real estate bust in the early 1990s when the construction boom in the 1980s created a huge oversupply of commercial space and reduced the availability of funds loaned to small and mid-sized businesses.

In some respects, according to Garner, commercial real estate is less worrisome today than it was in the '80s and early '90s. This type of construction is a smaller share of economic activity, and buildings' vacancy rates are lower. But, the economy is still vulnerable to any weakening in this sector, which would add to the problems from the housing and energy sectors.

But on the financial side, Garner says commercial real estate may be more worrisome today. A major difference from the early '90s is the increase of commercial real estate securitization, which may expose developers and investors to financial disruptions that originate outside the commercial real estate sector. Another significant similarity is that commercial banks currently have a large direct exposure to commercial real estate loans.

In commercial and multifamily real estate, construction booms and busts may reflect employment, market conditions and the like, but some factors that encourage overbuilding may be more specific to real estate. For example, long lag times and high expenses of a project may push a project forward even if there is evidence that market conditions are weakening. Also, real estate lenders may assess a proposed development based on the current or recent performance of the real estate sector rather than a realistic forecast of future prospects.

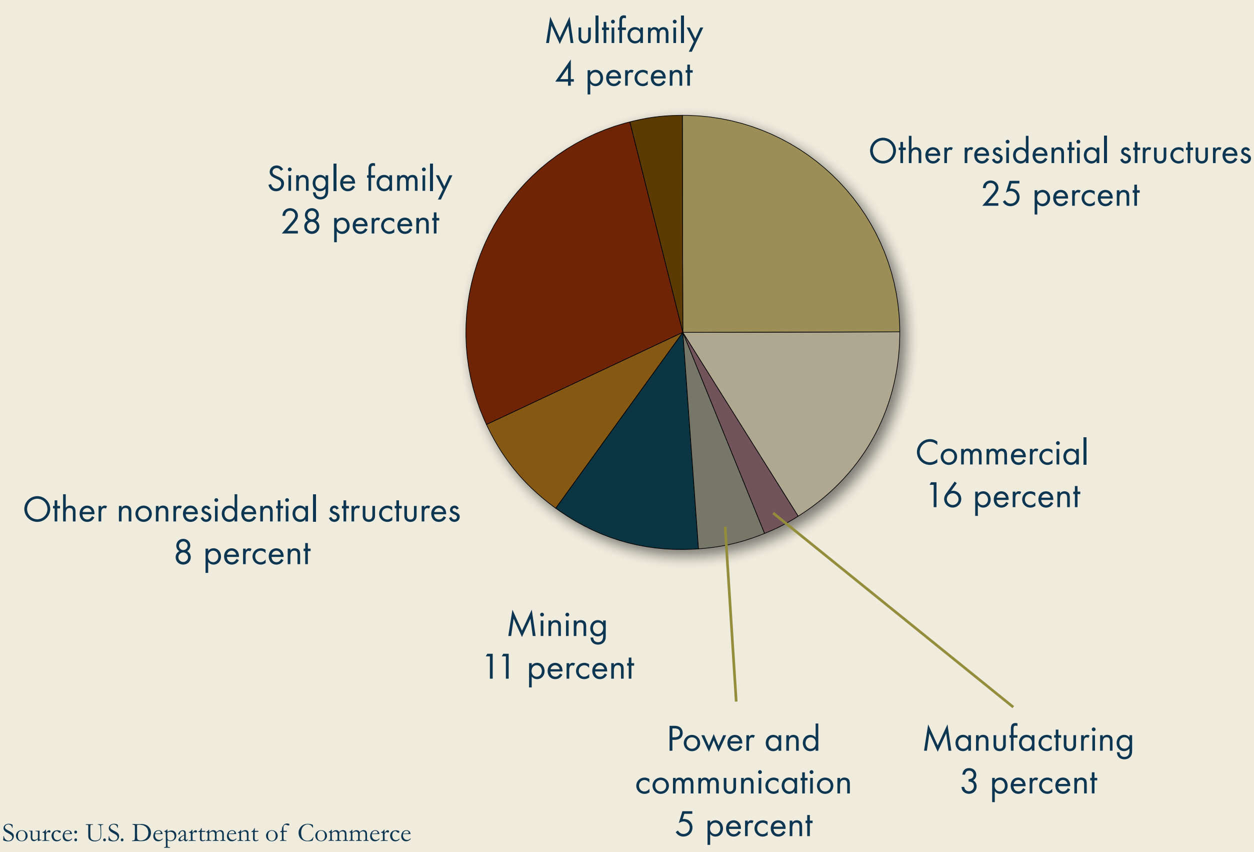
Garner says large fluctuations in commercial construction are not surprising from a historical perspective. Indeed, activity more than doubled from 1979 to 1985, and multifamily construction permits increased nearly 50 percent during this same time.

This boom was the result of many factors. Demand for office space expanded as a result of economic, structural and demographic changes—employment grew as more women entered the workforce and jobs shifted to services from goods. Changes in federal tax laws gave commercial real estate developers greater profits by lowering personal income and capital gains tax rates. Real estate lending by commercial banks grew strongly during this period because it was expected to be profitable. Savings institutions, such as savings and loans and mutual savings banks, also played an important role in this boom and bust when they were allowed to expand into commercial real estate lending.

"By the late '80s, supply surpassed demand," Garner says, "and the consequences to the economy were becoming apparent."

As a result of high vacancy rates and new tax law changes that reduced the after-tax return, commercial and multifamily construction

Components of U.S. private construction in 2007



Source: U.S. Department of Commerce

PHOTO BY GARY BARBER

LUEDER CONSTRUCTION CREWS IN OMAHA keep busy during the economic slowdown. The company president attributes this to the type of commercial projects they do, such as this church, which have fared better than retail projects.

slowed, but the reduction was too late to stem rising vacancies, which had climbed to nearly 19 percent nationwide by 1992.

"With such an excess of commercial and multifamily space, rent and property prices dropped and many real estate developers and lenders were hit hard with huge losses," Garner says. "The decline in commercial real estate construction helped cause the recession in the early 1990s. And, overbuilding and the resulting losses by real estate lenders contributed to a sharp increase in failures of financial institutions."

Current commercial real estate

"It's difficult to predict whether the commercial real estate boom-bust of the late '80s will be repeated today because the future supply and demand for commercial space is uncertain," Garner says. "But there is some evidence that suggests the commercial and multifamily markets may not face excess supplies as large as in the early '90s."

Demand during the next few years is difficult to predict, and as of now, it's definitely down at Millard Lumber in Omaha, says the company's CEO Rick Russell, much of which he attributes to consumers' confidence. Millard Lumber offers products and services for both residential and commercial projects, with most of its business centered on wood frames.

"People watch the news … it bothers them," Russell says. "The fundamentals are there, but the psychology isn't."

He can name a handful of already-financed projects that have been postponed due to nervousness. Many hope costs will drop—an attitude Russell calls "a terrible mistake" when prices, for lumber specifically, are at their lowest in years.

"Day-to-day, we're trying to remain positive," says Russell, who's been in the business since the '70s. "There's so much uncertainty out there."

Vacancies in existing structures also are a concern, but national office vacancy rates are lower now than in the years before the 1990-91 recession. The national office vacancy rate was about 13 percent in early '08, compared with 18 percent in 1989. At 9.4 percent in '07, the industrial vacancy rate for warehouses and other light industrial structures was about the same as in 1989, though this sector was not as overbuilt to the same degree as office buildings.

Kevin Nunnink, chairman of Integra Realty Resources, which is a nationwide real estate valuation and consulting firm, has seen a dramatic slowdown in retail leasing, which he attributes to low consumer spending affecting the retail sector. Nunnink is also a member of the board of directors of the Kansas City Fed.

A major difference between the earlier real estate cycle and the present one is the level of real estate securitization, Garner says. For commercial real estate, it grew from less than 2 percent in 1990 to more than 26 percent by the end of 2007. For multifamily mortgages, securitization grew from 11 percent to 31 percent during the same time period.

Securitization has both benefits and costs, Garner says. While it can stabilize real estate markets by evening out the flow of capital to the commercial real estate sector, providing more effective market discipline of developers, and spreading commercial property risk to a broader array of investors, securitization also can make the market vulnerable to financial shocks that had little effect on commercial property in the past.

Garner says another worrisome trend is that commercial and multifamily developers currently are relying more on debt to finance their projects than in the late 1980s. Commercial and multifamily mortgages were 24 percent of nominal output in '07, up nearly 4 percentage points from 1988. In addition, the prices of commercial property appear to be weakening after a period of sharp appreciation in the last few years.

On the positive side, while the exposure of commercial banks and savings institutions to commercial and multifamily real estate loans is somewhat higher than in the 1980s, real estate lenders may have maintained higher lending standards than in the past.

Whether the commercial real estate sector will suffer as much as the residential real estate market, "the jury's still out," Nunnink says. "I believe that if the capital markets loosen up, the impact to commercial real estate will be softer."

Back at Lueder Construction in Omaha, only one of the company's pre-construction projects—a fitness center—has been put on hold. Financing for new projects is available, although under tighter terms. Lueder is working to offset third-party risk from subcontractors it uses. And the company president is optimistic.

"We've seen it before," von Gillern says, "and we've survived it before."

"Day-to-day, we're trying to remain positive."

BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"IS COMMERCIAL REAL ESTATE RELIVING THE 1980S AND EARLY 1990S?"
By C. Alan Garner
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

PHOTO BY GARY BARBER

Survey of Community Banks in the Tenth Federal Reserve District

Community bankers in the region say their greatest challenges include the cost of regulatory burden and filling staff positions, according to a recent survey by the Kansas City Fed.

The goal of the 2008 Survey of Community Banks is to gauge how small commercial banks (those with assets less than $1 billion) respond to challenges, such as poor real estate markets, greater competition and regulatory changes, say Forest Myers and Eric Robbins, both policy economists at the Kansas City Fed. Myers and Robbins wrote the survey questions and subsequent research based on the responses.

The Kansas City Fed has conducted similar surveys for the last 20 years or so. The previous survey was in 2004 when banking conditions were good—earnings were strong, asset problems were few and bankers held a generally positive view for the future. This time is different, say Myers and Robbins.

With asset problems surfacing, charge-offs mounting, loan loss reserves falling and earnings declining, Myers says, "The banking environment has become less positive since our last survey. Our questions in 2008 were asked against a backdrop of more troubled times."

Overall, survey results show community bankers feel competitive pressure on deposit and lending business, driven in part by new and lower-cost technologies as well as changes in regulations that amplify this competition. Some of the areas emphasized by the respondents surprised Myers and Robbins. There were two main differences between the results of the '08 and '04 surveys:

- The cost of regulatory compliance (including the diversion of management's attention from business and what bankers perceive as an advantage given to less-regulated competitors such as credit unions) jumped from low on the 2004 list of challenges to the No. 1 spot in 2008.
- The second highest concern in 2008 was the ability to meet staffing needs because of the difficulty community banks say they have finding and compensating qualified personnel. In the 2004 survey responses, this was less of a

concern, especially for larger banks.

"After years of favorable business conditions, ongoing competitive and economic changes present many challenges for community banks," Robbins says. "The environment they're working in isn't easy, but many have strategies to compensate."

Competition

Community banks face increasing competition from many sources. Several factors are contributing to this change, including:

- Legal constraints on financial institutions' locations and activities have relaxed;
- Larger banks expanded into new markets through acquisitions and growth;
- More bank branches mean more choices for customers;
- Technology allows banks to expand their reach at a low cost.

"Loan and deposit competition is intense, to say the least," Robbins says.

Deposits remain a vital source of funding for community banks, and bankers surveyed said they expect other community banks to be their most intense competitors for these deposits. However, they think intense deposit competition also will come from credit unions (46 percent) followed by larger in-state banks (40 percent).

The competitive environment for loans is similar; however, community bankers showed more concern regarding competition from farm credit associations. (The Tenth District includes large rural areas dependent on agriculture.) This competitive concern jumped from third to first from the '04 survey to the '08 survey. Other loan competitors include captive lending subsidiaries, such as John Deere Credit, and credit unions.

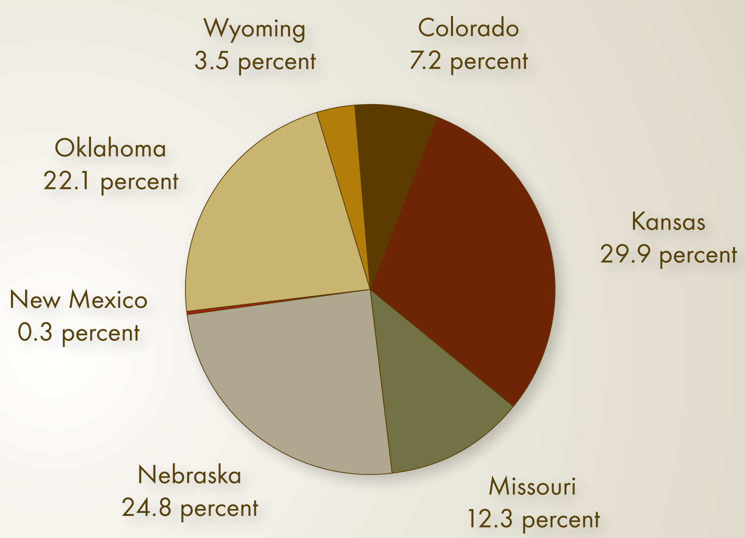
About the 2008 Survey of Community Banks

The Kansas City Fed created a 63-question survey that focused on four broad areas: general information about the bank; prospects and challenges; laws, regulations and guidance; and staffing practices and governance.

Surveys were mailed in February 2008 to all commercial banks with assets less than $1 billion in the Tenth Federal Reserve District. Of the 1,121 potential respondents, nearly 36 percent responded, which is high.

Similar surveys are conducted by the Kansas City Fed every three to four years. Responses are used for rural banking market analysis, policymaking discussions and for bankers to hear what their peers are saying. Bankers did not have to identify their organizations by name and could write comments at the end of the survey.

For a complete summary of the 2008 Survey of Community Banks in the Tenth Federal Reserve District, visit **KansasCityFed.org/TEN.**



Tenth Federal Reserve District survey respondents by state

In the open-ended portion of the survey, one respondent wrote, "Farm credit and credit unions combined will, and are, hurting our business. The tax advantage is huge and continues to make competing very difficult."

Another difference from the '04 survey is the increased competition stemming from advancements in technology, such as Internet banking, which allow online banks and brick-and-mortar banks to attract deposits.

These advancements are necessary to grow deposits, says John B. Schwartz, senior vice president, director and corporate secretary of State Bank of Blue Rapids in Kansas.

"Younger generations want and will demand more portable access to services," says Schwartz, who participated in the survey.

In response to these areas of heightened competition—and to increase customer deposits—survey respondents say they are utilizing a number of strategies, including acquiring other banks or branches, or adding new products and services.

Regulatory burden

The level of frustration among bankers regarding regulatory compliance requirements has increased substantially.

"This message comes across loud and clear in bankers' responses to how they rate the level of future challenges," Robbins says. "Among 17 factors, meeting regulatory compliance requirements was the No. 1 factor, while in the 2004 and 2001 surveys, it was seventh and eighth, respectively."

Mark Blazek, president of Oak Creek Valley Bank in Valparaiso, Neb., said the survey was a chance for him to voice some of his concerns in regard to regulations.

"The biggest concern we have as a small town community bank is the one-size-fits-all approach," Blazek says. "The smaller the institution, the more disproportionately the regulations impact us."

A number of factors may have contributed to this reaction among many community bankers, Robbins says. Congress and regulatory agencies responded to post-9/11 national security and other issues with new legislation in an effort to combat money laundering, terrorist financing and other requirements for security programs and privacy notices. As a result, the amount of time banks' boards spend on compliance matters has jumped, say 96 percent of survey respondents.

The majority of survey respondents, including Blazek, expect compliance to continue to be a significant challenge.

"If substantial regulatory relief is not forthcoming soon for small community banks, there will be few, if any, left," Blazek says.

Others said the level of regulation was disproportionate to the size of their bank. One respondent wrote, "At $20 million (asset size), we are regulated as if we were $20 billion."

> **"The environment they're working in isn't easy, but many have strategies to compensate."**

Economic challenges

Many banks in the District face slow-growing or declining populations and other challenges associated with being located in rural areas. Roughly 40 percent of survey respondents said lack of diversification opportunities to offset these challenges will be difficult.

One survey respondent wrote, "As the population ages, core deposits are going to move out of the banking system, and more expensive wholesale funding options will be necessary to maintain the balance sheet. Margins will compress and traditional banking services will become more expensive."

Bankers have responded to funding pressures in a variety of ways, such as using Internet posting services to obtain deposits, increasing their use of Federal Home Loan Bank advances and shortening the maturities of wholesale funding or CDs.

Regardless of recent market events and changes in funding costs, about 52 percent of banks surveyed believe their level of liquidity risk is low. Still, regulators urge banks to have contingency funding plans in place; about 67 percent of those surveyed do.

"Despite a downturn in economic conditions and increasing loan problems across the banking industry, survey respondents seem to be fairly positive about their ability to see things through to better times," Myers says. "Banks appear to be changing their lending strategies in response to these worsening economic conditions."

Staffing, governance

About 57 percent of community banks surveyed foresee problems hiring officers and about 43 percent predict challenges filling staff positions. The nature of community banks, which are often rural and in small towns, can complicate hiring. Survey results indicate larger financial institutions are more pessimistic, perhaps because they experience faster growth and are often located in larger areas where there's more hiring competition. Regardless of size, banks see filling teller positions as their biggest staffing challenge in the next five years, followed by loan administration and customer service positions.

"These are the highest percentages we have seen in our surveys," Myers says. "This may be, in part, reflective of the banking and economic conditions at the times the surveys were taken—for example, staffing concerns were higher during the poorer economic climates of 2001 and 2008."

In contrast, about 70 percent of community bankers don't think it will be difficult to fill board of director positions during the next five years. However, an increasing number say finding directors with the necessary skill set will be more difficult.

"The amount of staffing and training has become a major expense factor to the banking industry," says Dick Scarlett, chairman of United Bancorporation of Wyoming, which oversees Jackson State Bank in Jackson Hole.

Blazek, of Oak Creek Valley Bank in Nebraska, agrees that "there is always a demand for good, strong, experienced loan officers. That can be a challenge" for small, rural banks, although Oak Creek Valley's proximity to the Lincoln area and its job pool is beneficial.

Going forward

The responses of these surveys are valuable to both the Kansas City Fed and the community banks themselves.

"The aggregate results of such a survey should be very helpful in spotting trends in banking at the grassroots level," says Schwartz of State Bank of Blue Rapids in Kansas.

The high response rate for the survey can, in part, be attributed to community bankers wanting to speak directly to the Fed, say Myers and Robbins.

Says Scarlett, of United Bancorporation, "I feel the information I'm able to share from our market area will somehow be meaningful to the Fed in better understanding what is happening in the Tenth Federal Reserve District."

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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"THE 2008 SURVEY OF COMMUNITY BANKS IN THE TENTH FEDERAL RESERVE DISTRICT"
By Forest Myers and Eric Robbins
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

About...

Adding *it all* up

ELEMENTARY STUDENTS IN OMAHA talk with TOM HOENIG, president of the Kansas City Fed, about personal finances and the economy.

PHOTO BY BOB ERVIN

Kansas City Fed committed to financial literacy for all ages

Whether it's a traveling trunk of classroom activities, free lesson plans for teachers or a family visit to the interactive Money Museum, the Federal Reserve Bank of Kansas City has a variety of resources for teachers, students and the public to better understand economic concepts in a fun and meaningful way.

These efforts are part of the Kansas City Fed's goal to help people of all ages and backgrounds learn how to manage their finances and make sound economic decisions—concepts that are critical to functioning in today's changing economy, says Lowell Jones, assistant vice president in the Public Affairs Department, which is responsible for the Fed's regional economic education.

"We want people to better understand how the Federal Reserve and our economy function, and what financial tools are available to them," Jones says. "Informed consumers are the backbone of a strong economy—that is why the public education role the Kansas City Fed plays is so vital. The return on our investment is immeasurable."

For the classroom

Staff members at the Kansas City Fed and its Branches in Denver, Oklahoma City and Omaha connect with both teachers and students throughout the region, promoting financial literacy and building relationships, says Jennifer Clark, who oversees the economic education program for the Tenth Federal Reserve District.

"One of our top priorities is equipping teachers with the resources they need to share economic and financial concepts with their classes," Clark says. "Through the years, a teacher reaches hundreds of students. The Fed wants to give educators tools to teach lessons that stick with children into adulthood."

These efforts are free and include various events and workshops for educators throughout the region, ranging from the "Teacher Open House" in Kansas City to "The Consumer in Today's Economy" workshop in Albuquerque.

Teachers receive grade-specific lesson plans and classroom materials on everything from saving to economic concepts. Fed staff at some of the offices offer financial literacy lessons during classroom visits.

Longer, in-depth sessions geared toward kindergarten through 12th-grade teachers and high school students are also available. Teachers learn how to better incorporate financial and economics lessons into their curriculum, while high school students are introduced to topics such as the Great Depression and the operations of the Federal Reserve System.

Additionally, Michele Wulff, an economic education coordinator at the Kansas City

Fed's Omaha Branch and a former teacher, writes curriculum; presents workshops in the region and at national educational conferences; and develops economic education materials, including:

- "Teaching Tips" discussion questions to accompany Fed research for high school students;
- Grade-specific personal finance lesson plans and role plays on saving, the payments system and online banking;
- "Fifty Nifty" economic concept cards and teacher guide for kindergarten through sixth grade;
- "Traveling Trunk" of economic education and Federal Reserve materials and activities for classroom use.

Throughout the year, the Kansas City Fed sponsors economic education-related events for students, including the Economic Essay Contest.

"When taught early, children start to build a foundation for better understanding economics and finances," Wulff says. "Even young students can understand basic economic concepts—that is why many of the newest resources we are developing focus on strengthening elementary-level resources for teachers to use in the classroom."

The Money Museum

The 3,000-square-foot museum is a part of the Kansas City Fed's recently built headquarters at 1 Memorial Drive in Kansas City, Mo. The exhibits, which have touch screens with video and text, appeal to visitors of all ages. Since opening in July, the museum has welcomed more than 2,000 guests.

Admission and parking are free. Guided and self-guided tours are available weekdays during regular business hours.

Highlights include:

- Seeing a portion of the region's largest cash vault and the automated vehicles moving money;

AREA TEACHERS ATTEND AN OPEN HOUSE at the Kansas City Fed, which provided free materials to assist with their financial education lessons.

For more information on student and teacher resources, academic competitions, events and Money Museum tours, and to order free publications, visit KansasCityFed.org/TEN.

PHOTO BY GARY BARBER

• Hands-on exhibits for young children to learn about the economy, such as creating their own currency, stepping into the role of a bank examiner and more;

• Browsing through the Truman Coin Collection, which has more than 450 coins from every presidential administration;

• Watching "The Fed and You" short film on the 12-foot-long video wall;

• Taking a look at the "Legacy Exhibit," which has artifacts dating back to the Kansas City Fed's opening day in 1914.

Student-group visits can include an age-specific, 30-minute presentation led by Fed staff. Additionally, educators can choose from a range of pre- and post-visit lesson plans for fifth- through 12th-grade classroom use. These plans are designed to help further engage students and provide instructional aid to teachers before, during or after their visit, Wulff says. Take-home activities, such as a money activity guide that includes games and fun facts, are offered for families after their tour. All presentations and materials are free.

Economic Education Advisory Council

The direction of the Kansas City Fed's economic education initiatives is determined by its staff based on feedback from members of the Economic Education Advisory Council. The council is made up of a dozen education professionals from the Kansas City metro area, including teachers from the elementary through university levels as well as youth leadership programs.

Members meet quarterly to accomplish several goals, including assessing educators' needs, strengthening partnerships, and identifying and pooling resources in support of financial literacy, says Gigi Wolf, an economic

PHOTO BY GARY BARBER

education specialist at the Kansas City Fed who coordinates the council's efforts.

"Who better to speak to the needs of students than those working with them day-to-day," Wolf says. "The council provides valuable insight on how the Federal Reserve can help prepare kids to make good economic decisions as adults."

Council member Michael Byrd knows firsthand the importance of early education. When Byrd was an officer in the U.S. Army, part of his job was to advise young soldiers with personal financial problems.

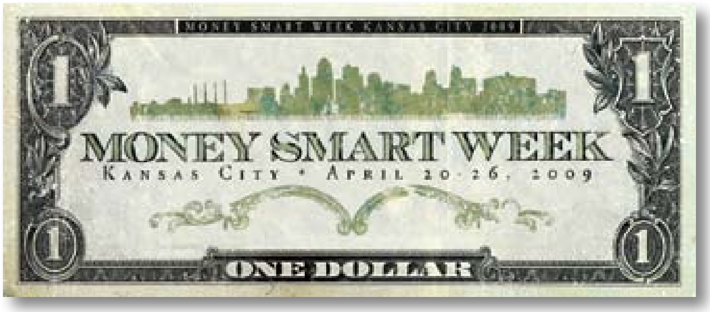
"I can't be out of money," Byrd remembers hearing, "I still have checks in my checkbook."

Most were young and had never been taught how to manage money. Now a retired lieutenant colonel, Byrd incorporates financial literacy into the Junior ROTC program that he oversees for seven high schools in the Kansas City Missouri School District. The program has 25 staff members and about 2,100 student cadets. He is assisted by the Kansas City Fed with instructional training, lesson plans and more.

"A basic understanding of functional economics is critical to any citizen," Byrd says. "The earlier children are exposed to these activities … the more skillful they become."

BY BRYE STEEVES, SENIOR WRITER

Notes



KC 'Money Smart Week' coming this spring

Kansas City-area residents can attend free workshops designed to heighten their financial awareness April 20-26 during the annual Money Smart Week.

The Kansas City Fed is partnering with other organizations, including the FDIC, the United Way, Consumer Credit Counseling Service, Central Bank of Kansas City and the Mexican Consulate to let consumers know about financial resources available to them. At the same time, this community outreach effort is a chance to raise awareness among policymakers, employers, educators, social service organizations and others about the importance of financial education, says Gigi Wolf, an economic education specialist at the Kansas City Fed.

"Information and resources can assist individuals of all backgrounds in making positive financial decisions, which benefits our economy as a whole," Wolf says.

For more information, visit KansasCityFed.org/TEN.

Foreclosure mitigation resources available

In an effort to prevent unnecessary foreclosures and ease the effects of those that do occur, the Federal Reserve developed an online toolkit of resources.

The toolkit includes data and maps on foreclosure trends and hotspots, information on foreclosure laws, and local resources and events for displaced homeowners.

The resources in the toolkit are presented as a four-step process:
• assess the foreclosure situation;
• reach troubled homeowners;
• establish post-foreclosure support systems;
• preserve neighborhoods.

"The Fed views the high rate of mortgage foreclosures as an urgent problem," says Kelly Edmiston, a Kansas City Fed senior economist who wrote much of the materials. "The goal of this toolkit is to provide resources to address the current turmoil in the housing market and minimize the impact of foreclosures on neighborhoods."

This toolkit is a part of the Kansas City Fed's ongoing work to address foreclosures, including hosting events throughout the region, conducting research, and partnering with other regulators, community groups, policy organizations, financial institutions and public officials. Much of Edmiston's research focuses on housing issues and the current foreclosure crisis.

To access the toolkit, visit KansasCityFed.org/TEN.

Money Smart Nebraska educates consumers through free events

The first annual Money Smart Nebraska in November saw thousands turnout for the weeklong, statewide financial literacy effort.

Free activities were offered to every income level and covered all facets of personal finance, ranging from establishing a budget to first-time home buying to estate planning. Events were sponsored by the nonprofit Nebraska Financial Education Coalition, banks, financial planners, schools and other organizations. The Kansas City Fed also was a participant, believing financial literacy for all consumers is the backbone of a strong economy.

"Money Smart Nebraska offers unbiased financial education, aimed at building consumers' knowledge while helping them handle their finances more effectively," says Jennifer Clark, who oversees the economic education program for the Kansas City Fed in its Omaha Branch.

Kansas City Fed President Tom Hoeing spoke at the week's kickoff luncheon in Omaha, and also to students at Conestoga Magnet School, who asked him questions about the economy and other related financial questions.

"We know that financial literacy means a better future for those who are better informed," Hoenig says.

For information about future Money Smart Nebraska events, visit MoneySmartNebraska.org.

PHOTO BY BOB ERVIN

Free publications for all audiences

The Federal Reserve offers hundreds of free titles on a variety of economic-related topics, including financial markets, financial education, money, banking, payments system and the Federal Reserve System.

Publications include comic books, such as "Once Upon A Dime" and "The Story of Inflation," that explain financial and economic subjects in an easy-to-understand manner for students. Many, such as "Know Before You Go … Get a Mortgage" and "How to Establish, Use and Protect Your Credit," are beneficial for consumers and encourage them to make informed financial decisions.

Other publications explain the ins and outs of the financial system, such as the development of credit markets, and the Fed's role in the economy, including the Fed's history and its functions and operations.

To view, order or subscribe to Federal Reserve publications, visit KansasCityFed.org/TEN.

Economic workshops for educators

The Kansas City Fed and its Branches in Denver, Oklahoma City and Omaha offer economic workshops for elementary and secondary educators as well as those at area universities.

"The purpose of these workshops is to provide educators with a better understanding of economics and the Federal Reserve System, as well as to contribute to the economic and personal finance lessons they teach in the classroom," says Trudie Hall, special programs coordinator at the Kansas City Fed.

The sessions often include one or more speakers on the Fed or economic and personal finance topics; an overview of the Federal Reserve's resources that are available to educators; and a tour of the Fed, where available.

To schedule a workshop at the Fed office nearest you, visit KansasCityFed.org/TEN.

Bank Anniversaries

The following banks in the Tenth Federal Reserve District are celebrating one, five, 10 or 20 or more years as Federal Reserve state member banks in January, February or March.

Colorado B&TC of La Junta	La Junta	Colo.	85
Lusk State Bank	Lusk	Wyo.	75
St. Marys State Bank	St. Marys	Kan.	73
First Community Bank	Taos	N.M.	71
Community B&TC	Neosho	Mo.	67
Colorado Mountain Bank	Westcliffe	Colo.	30
Bank at Broadmoor	Colorado Springs	Colo.	29
First State Bank	Wheatland	Wyo.	28
First Option Bank	Osawatomie	Kan.	10
Bank of Commerce	Chanute	Kan.	5
Bank of Eufaula	Eufaula	Okla.	5
Bank of Parsons	Parsons	Kan.	5
Chetopa State B&TC	Chetopa	Kan.	5
First Neodesha Bank	Neodesha	Kan.	5
First State Bank of Thayer	Thayer	Kan.	5
Five Points Bank	Hastings	Neb.	5
Home State Bank	Erie	Kan.	5
Thunder Bank	Sylvan Grove	Kan.	5
Union State Bank	Everest	Kan.	5
United B&TC	Marysville	Kan.	5
Platte Valley Bank	Scottsbluff	Neb.	1
Platte Valley Bank	Torrington	Wyo.	1
Tri-County National Bank	Cheyenne	Wyo.	1
Union Bank	Oklahoma City	Okla.	1

Compiled By TEN Staff

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Winter 2009

VOLUME 4 • NUMBER 3 • ISSN 1554-7469

The Federal Reserve System

Congress created the Federal Reserve in 1913 to bring financial stability after a number of banking panics. It is the nation's third central bank. The first, established in 1791, and the second, created in 1816, were each operational for 20 years. In both cases, its charter failed to be renewed and the banks closed.

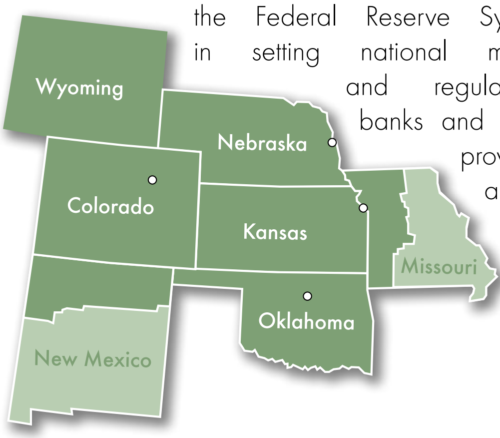
With the Federal Reserve Act, Congress sought to create a central bank the public would be more likely to support by making it "decentralized" with more local control. This new structure was designed to overcome one of the primary weaknesses of the previous central banks: public distrust of an institution that many felt could potentially be under the control of either government or special interests. The new central bank is a network of 12 regional Federal Reserve Banks, located throughout the country and under the leadership of local boards of directors, with oversight from the Board of Governors in Washington, D.C., a government agency.

The Federal Reserve is considered to be independent within government and broadly insulated from political pressures. While members of the Board of Governors are nominated by the president of the United States and confirmed by the Senate, the Federal Reserve's regional structure, including local boards of directors and advisory councils, ensures that views from a broad spectrum of the public nationwide contribute to the central bank's deliberations.

President Woodrow Wilson signed the Federal Reserve Act on Dec. 23, 1913, and the 12 regional Federal Reserve Banks opened on Nov. 16, 1914.

The Federal Reserve Bank of Kansas City

The Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha serve the Tenth Federal Reserve District, which encompasses western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico. As a part of the Federal Reserve System, the Bank participates in setting national monetary policy, supervising and regulating numerous commercial banks and bank holding companies, and providing check processing and other services to depository institutions.



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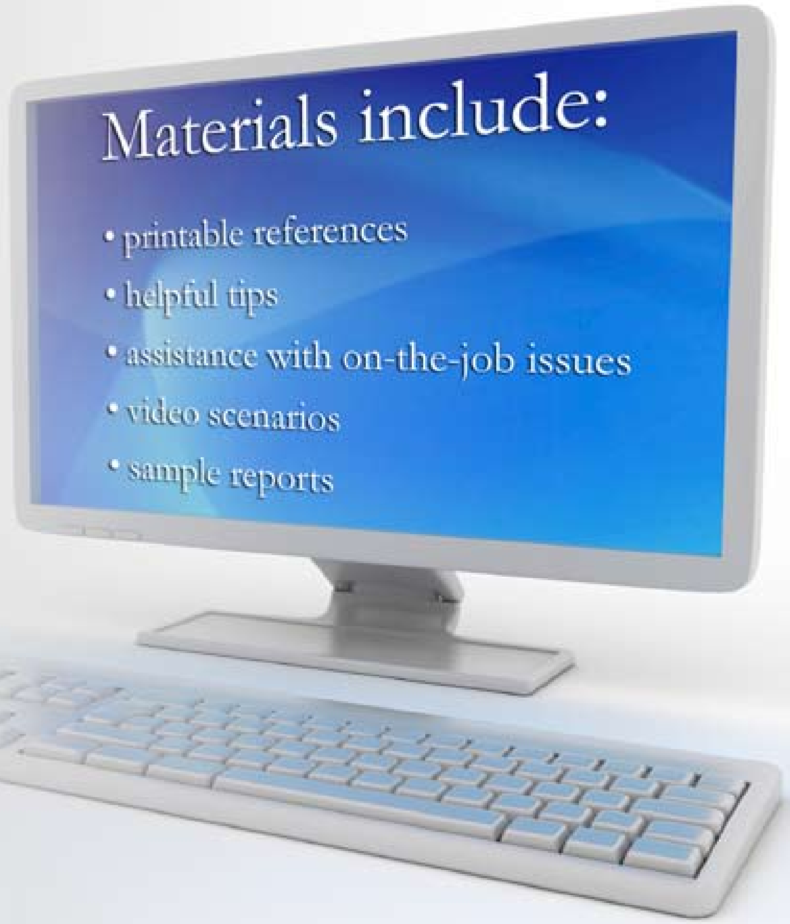
COVER PHOTO: Joshua Lawton

TEN magazine is a quarterly publication of the Federal Reserve Bank of Kansas City focused on the connection between the Bank's research and the Tenth Federal Reserve District. **TEN** also features articles on the Federal Reserve's history, structure and operations.

The views and opinions expressed in **TEN** are not necessarily those of the Federal Reserve Bank of Kansas City, the Federal Reserve System, its governors, officers or representatives.

For a free subscription, please visit **KansasCityFed.org/TEN** or call 816-881-2683.

What *every* bank director *needs* to know



The Federal Reserve offers free online training resources, including the updated *Insights for Bank Directors* course.

For materials that help directors ask pertinent questions and apply knowledge, visit KansasCityFed.org/TEN.

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