



Audit Report



OIG-11-002

SAFETY AND SOUNDNESS: Failed Bank Review of First Federal Bank of North Florida

October 15, 2010

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

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MEMORANDUM FOR JOHN E. BOWMAN
ACTING DIRECTOR
OFFICE OF THRIFT SUPERVISION

FROM: Susan L. Barron /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of First Federal Bank of North Florida

This memorandum presents the results of our review of the failure of First Federal Bank of North Florida (First Federal). First Federal was opened in 1922 and had a main office in Palatka, Florida, and six other offices located in Crescent City, Interlachen, St. Augustine, St. Augustine Beach, Hastings, and Welaka, Florida. The Office of Thrift Supervision (OTS) closed First Federal and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on April 16, 2010. As of December 31, 2009, the thrift had \$393.9 million in total assets. FDIC estimated that the loss to the Deposit Insurance Fund is \$6 million.

Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of First Federal that was limited to (1) ascertaining the grounds identified by OTS for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OTS reports of examination for the 5-year period before the bank failure, and (3) interviewed OTS examination personnel.

We conducted this performance audit during August and September 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Causes of First Federal's Failure

The primary causes of First Federal's failure were its aggressive growth strategy and excessive concentrations in higher-risk commercial real estate and land loans. These conditions were exacerbated by the severe downturn in real estate values in Florida, First Federal's market. In addition, credit administration practices at the bank were unsound. For example, First Federal was criticized by OTS in the 2007 and 2009 report of examinations for using stale dated financial reports during its internal loan reviews. Furthermore, the internal loan reviews were also not being performed timely or adequately, and were not being performed independently from the originating loan officer. First Federal experienced rapid asset quality deterioration beginning in 2007, resulting in significant increases in its problem assets and loan losses. In turn, these loan losses significantly diminished earnings and capital and, ultimately, led to First Federal's failure.

Conclusion

Based on our review of the causes of First Federal's failure and the grounds identified by OTS for appointing FDIC as receiver, we determined that there were no unusual circumstances surrounding the thrift's failure or the supervision exercised by OTS. Accordingly, we have determined that a more in-depth review of the thrift's failure by our office is not warranted.

We provided a draft of this memorandum to OTS management for comment. In its response, OTS stated that the primary causes of First Federal's failure summarized in this memorandum are consistent with the information contained in its reports of examinations and documents in support of the grounds for receivership. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-5776 or Jai Mathai, Audit Manager, at (202) 927-0356.

Attachments

**Office of Thrift Supervision**
Department of the TreasuryThomas A. Barnes
Deputy Director, Examinations, Supervision, and Consumer Protection

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October 7, 2010

MEMORANDUM FOR: Susan L. Barron,
Director, Banking Audits
Office of Inspector General
U.S. Department of the Treasury

FROM: Thomas A. Barnes /s/
Deputy Director

SUBJECT: Draft Failed Bank Review of
First Federal Bank of North Florida

Thank you for the opportunity to comment on your draft memorandum entitled "Failed Bank Review of First Federal Bank of North Florida." Because the estimated loss of \$6 million to the Deposit Insurance Fund is below the \$200 million threshold set forth in section 38(k) of the Federal Deposit Insurance Act, the review of the failure of First Federal Bank of North Florida was limited to ascertaining the grounds identified by OTS for appointment of a receiver and determining whether any unusual circumstances exist warranting a more in depth review.

The memorandum summarizes the primary causes of First Federal Bank of North Florida's failure. Except as noted below, the causes cited are consistent with the information contained in the OTS Reports of Examination and documents in support of the grounds for the receivership. Specifically, the memorandum cites the bank's aggressive growth strategy and excessive concentrations in higher risk commercial real estate and land loans, exacerbated by the severe downturn in the Florida real estate market, as the primary causes of the failure. The memorandum further cites unsound credit administration practices as a contributing factor to the loan losses that diminished earnings and capital at the institution.

The memorandum identified no unusual circumstances surrounding the failure or the supervision exercised by OTS warranting a more in depth review by the Office of Inspector General. No recommendations for OTS were made in the memorandum.

Thank you again for the opportunity to review and respond to the draft report. OTS appreciates the professionalism and courtesies provided by the staff of the Office of Inspector General.

Department of the Treasury

Deputy Secretary
Office of Strategic Planning and Evaluations
Office of Accounting and Internal Control

Office of Thrift Supervision

Acting Director
Liaison Officer

Office of Management and Budget

OIG Budget Examiner